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LEVERAGING OFFSHORE FINANCING TO EXPAND AFRICAN NON-TRADITIONAL EXPORTS: THE CASE OF THE HORTICULTURAL SECTOR

Study prepared by the UNCTAD secretariat

Contents

INTRODUCTION

Africa as a whole accounts for less than 2 per cent of world trade, although it has more than 10 per cent of the world's population. Sub-Saharan African countries are deemed to depend heavily on a few traditional commodity products, in particular crude oil, coffee, cocoa, cotton, tea and mineral products, for their export earnings. For the past two decades, the share of export prices in the final shelf prices in importing countries of all these commodities has been shrinking to their levels of the 1970s, and export revenues in real terms have been decreasing.

The low level of African exports has been viewed as a critical factor contributing to the continent's general state of underdevelopment and to the spread of poverty in spite of various poverty reduction initiatives by both governmental and non-governmental agencies.

Over the years, various African Governments have made concentrated efforts to boost the production of cocoa, coffee, cotton and other traditional commodities. At times of excess supply and/or low global demand such those as currently being experienced, prices slump to previously unseen levels.

Commodities diversification represents a significant economic opportunity for Africa. In recent years, some countries in the African region have started to explore the prospects of developing non-traditional commodities for export. This includes the development of horticulture products (fruits, vegetables and floriculture products) with international market potential, as well as moving up the value chain of existing products.

The growth in horticultural production has been driven not only by increasing demand, but also by supply-side factors. Predominant in this is a global change of government policies that distorted incentives for farmers, encouraging them to grow staple crops. For example, countries such as Egypt, Kenya, South Africa and Zimbabwe have made structural reforms and have changed their land use and land ownership policies in recent years, thus enabling farmers to move from traditional crops to fruits and vegetables, and replicating Chile’s horticultural production boom which followed its 1974 reforms of farmland property rights. The growth of African horticultural exports has been further encouraged by the reduced import duties or increased duty-free imports to which many countries have been entitled when exporting to OECD countries (as, for example, under the Lomé Convention and its successor Cotonou Convention, ACP countries have duty-free access for many of these commodities).[1]

Horticulture is a sector which, if properly utilized, can help countries reduce rural poverty, earn foreign exchange and bring in much-needed foreign investment and know-how to fuel economic growth. African countries have comparative advantages in land and labour costs, and can often benefit from differences with regards to their main potential markets in terms of seasonality and climatic conditions.

However, the development of the horticulture sector requires significant levels of funds, which unfortunately are lacking in Africa. Access to international funding has been difficult as a result of various performance and country risks. International banks began to shy away from direct financing to African entities in the wake of serious external sector imbalances in the late 1980s, during which time most of the Governments defaulted on their foreign exchange commitments. As a result, the developed country central banks stipulated full provisioning for all bank lending to African entities. Such directives have resulted in the reluctance of the banks to do African deals under plain vanilla structures. The advent of structured trade and project financing has provided some measure of relief in attracting offshore funds into Africa. Such financing has mostly been for the traditional products with high vulnerability to external shocks (as has been experienced in the cocoa and coffee sectors).

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[1] It should be noted, however, that market access is still far from perfect, despite zero tariffs. There are also many non-tariff barriers, such as import levies, quarantine regulations and phytosanitary requirements, that are often applied to protect local producers from foreign competition.

The question that is posed in this paper is the following one: how can (prospective) African producers/exporters (specifically of non-traditional commodities) secure access to offshore finance? One way to address this question is to examine the role of the various parties in the funding and reimbursement chain with a view to ascertaining how each can impact positively on the continent's trade and development aspirations. How can parties with a role in influencing horticulture trade finance (i.e. local banks, African exporters/associations, African Governments, international banks, offshore buyers/auction floors, insurance companies and rating agencies) contribute to boosting non-traditional export performance in Africa by leveraging offshore financing? The paper will explore opportunities and ways to finance the horticultural trade sector in Africa as suggested by existing success structures and case studies – what were the structures, risk mitigation techniques and other essential elements that led to their success?

Chapter I

RISKS AND CONSTRAINTS IN FINANCING AFRICA'S HORTICULTURAL TRADE

The financing needs of African operators in the horticulture industry are significant as their private capital is limited and the expenses and requirements involved in developing their business are multiple. Financing leverage is required for virtually all aspects of horticultural operations – planting, transportation, preservation and export. The elementary factors of production are land, labour, capital and entrepreneurship. In many African societies, land is universally available, at least for the planting of varieties of flowers and vegetables (which are intensive crops). There is an abundance of labour and some level of skill in horticultural management. The main element lacking is capital. There is a need for financing to fund acquisition of necessary equipment and inputs for planting, harvesting and preservation of produce prior to export. Even the movement of produce from farm gates to the port of export requires the use of specialized trucks, which are expensive. The necessary capital is not readily available to growers and exporters.

Box 1
Characteristics of market chain structures for fresh fruits and vegetables

Of all the different sub-sectors within the food industry, fresh fruits and vegetables have a chain of supply which displays unique characteristics.

Fruit and vegetables are labour-intensive horticultural crops, traditionally grown by small family enterprises. However, many large national and multinational fruit (mainly bananas and pineapples) and vegetable enterprises are now active in the market. In order to increase their market power, many of these smaller growers have organized themselves into sales organizations.

Fruit and vegetables are traded as fresh perishable products, and this makes the time factor and packaging critical.

Since nearly every single country in the world is involved in the trade, there are a very large number of exporting and importing countries and a wide range of companies.

The range and the origin of fruit and vegetable products are becoming increasingly wide and they may shift from season to season. Supply may vary greatly from season to season, depending on the weather and price fluctuations. For instance, fruit from one destination or of one kind may easily be replaced by fruit from other sources or of other kinds. At the same time, consumers may easily shift from one fruit to another when they think the prices for a certain fruit are too high.

Price fluctuations and limited market power are not to the advantage of producers and exporters (mainly because they will rarely benefit from very high prices in years of shortages). This leads producers and exporters to constantly search for possibilities to earn premium prices, and the role played by technology and research, organic and fair-trade labelling, and other innovations (packaging, branding, etc.) and industrialized production is becoming increasingly important.

A large number of retail outlets and formats exist, varying from large retail chains to small restaurants.

Source: Largely from "Worldwide impact of horticulture" by Urbain Avermaete, World Conference on Horticulture research, 17-20 June 1998 in Rome, Italy.

In this chapter, some of the limiting factors that prevent financiers from providing financing for horticultural activities in Africa are examined.[2] Horticulture players generally suffer from the problems described below.

Under capitalization

Many growers and operators in the horticulture sector in Africa are small family enterprises. They make no attempts (or do not have the capacity) to inject equity funds into the business, waiting for the banks to provide even set-up funds. Their only contribution is generally ancestral land. But, banks do not view this as an indication of serious commitment to the ventures by their promoters, and are therefore reluctant to provide funds. Some bank credit policies stipulate a certain level of financial commitment by the promoter to a business for it to qualify for advances.

Low collateral

In the absence of any significant equity capital, these operators are unable to acquire the necessary equipment for their activities. In essence, what they make available as collateral is only land, for which at times they have no adequate title documents. Lenders are not always comfortable with this arrangement as it means that the borrower has no stake to protect in the operation, a fact which could have a direct bearing on his commitment to its success.

Poor expertise

One of the main constraints on horticultural development in Africa is the limited technical and managerial capabilities of African operators to acquire and apply appropriate and up-to-date production and post-harvest handling technology on the one hand, and to run a horticultural farm as a profitable business on the other. It is hard to find professionals in botany or related agricultural studies venturing into the growing of horticulture and floricultural plants on a commercial scale. This leaves, in some circumstances, the field to amateurs looking for easy returns. Cultivation of horti/floricultural plants is much more than mere tree planting. Banks will obviously prefer to deal with professionals who have not only a good knowledge of plant behaviour but also good managerial and business skills.

High operational costs

The perishable nature of the products entails very high operating costs. Such costs stem from expensive and sometimes inadequately and expensively supplied inputs (including high fuel costs), and specialized means of transport, as well as from the extreme urgency involved in handling products - from crating to on-loading for export. All this not only means high insurance costs (most growers and exporters usually take out insurance on crop and delivery from the time the product is on the farm up to the time it arrives at the airport ready to be shipped) but also constitutes one of the biggest risks in horticulture trade finance since unless the produce is delivered to the market in time, its quality may deteriorate; if that happens, it will be rejected or much lower prices will be paid for it.

Furthermore, with insufficient government support in the form of provision of infrastructure, for example irrigation projects, farmers are left with the option of sinking bore-holes - at enormous cost - to water their plants. In addition, insufficient or no maintenance of such key infrastructure as roads, railways, energy and telecommunications networks causes inefficiencies that in turn cause additional

[2] The information in this chapter and the following one is mainly drawn from discussions in two regional meetings (Mali/Bamako in February 2001 and Kenya/Nairobi in May 2001) that UNCTAD organized on "Diversification and development of the horticultural sector in Africa" (website: http://www.unctad.org/infocomm/Diversification/index.htm), as well as from responses of a number of banks to a questionnaire submitted to them by UNCTAD on that issue. From the responses, there appears to be some measure of uniformity in the nature of problems they encounter.

costs in the supply chain from production to market outlets, for large as well as small producers. As a result of these costly elements, profit margins are severely eroded, and this leads to fears by banks that cash flows from such activities may not be sufficient to service loans.

Inadequate carriers

Bankers are also concerned that growers and exporters may not find a ready freighter to transport the cut plants or fruit and vegetable produce to the market as and when desired. A few years ago, Zimbabwe used to have seven daily flights ferrying products to Europe. But as inward cargo dried up, this has been reduced to only two flights daily. This became the only option since freighters cannot charge exporters for losses on the cargo-free inward trip, which in any case would make their products far more expensive than market realities.

Pests and adverse weather conditions

In most African countries, meteorological services are very inadequate, and this leads to inaccurate prediction of weather behaviour. In effect, farmers simply do blind cropping, resigning themselves to fate. Moreover, in the absence of standard pest control measures, agricultural activities become extremely risky and unattractive to lenders.

Product seasonality

The seasonal nature of activities in the sector affords lenders little room to make medium- and long-term facilities available to either the growers or the exporters. Short-term advances are naturally more expensive and do not provide any reasonable opportunity for flexibility. There is a fear that if, for any reason, the farmer failed to plant at the appropriate time, there would be a shortfall which would affect the servicing of loans.

Market/price risks

These risks are very important, particularly when the market has an oversupply of perishable products. The prices of horticultural produce could drop drastically during the term of the transaction, which will make it in such circumstances difficult for producers/exporters to service their loans. At the same time, it may often be difficult to secure a fixed price contract. This situation would result in a higher safety margin for the financiers and less credit to the growers.

When growers are dealing directly with supermarkets, the price risk may seem lower because the sale is often at a pre-set price; but on the other hand, the market risk is higher as the quality standards requested by the buyers are very rigid and could lead to rejection of the produce (unlike auctions, where there is an open market and thus a seller is relatively sure that the product will be sold, but at a price determined by its quality and by market demand).

Storage risk

A critical measure of quality for horticultural and floricultural products is freshness. In most of the countries where such products are produced storage facilities are inadequate and road networks dilapidated. Where storage facilities are available, constant power outages can cause spoilages and deterioration in quality. Of course, in such circumstances, loans could go bad.

Loan diversion

Bankers have expressed their concerns about the tendency of beneficiaries of loans to divert them to other crop production or in some cases to other domestic needs. Where this happens, the ability to repay loans becomes jeopardized. Generally, there appears to be a tendency among farmers to want to switch to other crops at the slightest hint of improvement in their prices or to choose to sell to higher bidders, thus not executing their initial sales agreement. In such circumstances, appropriate market feasibility studies and appropriate monitoring may need to be carried out in order to avoid serious potential for failures.

Non - existent local market

The virtual non-existence of markets for horticultural products in Africa poses a grave danger to growers. This is because, at a time of refusal of goods by international buyers (owing to quality issues) or the inability of exporters to ship the goods (due to *force majeure* events, such as the airline strike or the truck drivers' road blockade in Europe few years ago), there would be little or no chance at all of marketing products in the local market, at least to recover basic operational costs. The question here is how long the products could last if the strikes continued. This scenario is obviously an issue of concern to lenders.

Chapter II

HOW CAN VARIOUS PARTIES PLAY A ROLE IN STRUCTURED FINANCE FOR HORTICULTURE TRADE IN AFRICA?

The widespread constraints described in the previous chapter explain the general reluctance of financiers to make credit available on reasonable terms to the horticultural sector in Africa. In addition, with the disappearance of many agricultural banks, development banks and other specialized banks in most African countries, the general inclination of formal financial institutions was to neglect this sector and concentrate mainly on a few major clients in major cities. Local funds are generally not available, but where they are provided, lending rates are quite prohibitive, and terms and conditions are not compatible with the requirements of the industry. Even then, most exporters and growers may not have suitable collateral instruments that may be required by the banks.

Box 2
Cut-flower production in Africa

Most African countries grow flowers mainly to meet European consumer demand. The African countries make use of certain market opportunities, such as supplementing the European market during the winter and cultivating species which are hard to grow in Europe or which require too much energy because of their long growing times. These countries benefit from a developing infrastructure, knowledge, transport facilities and entry to the European market in particular, owing to trade agreements with the EU. Nevertheless, although the African growers have basic advantages in terms of production costs (adequate supply of cheap land, water and labour) and favourable climate, countries are faced with obstacles such as lack of proper infrastructure, lack of proper technologies, transport and logistics problems, and welfare and ecological issues.

The first cut-flower nurseries were established in 1969 in Kenya, originally a coffee - producing country. Nowadays there are over 1,000 flower farms in the country (although 75 per cent of total exports are supplied by just two dozen large or medium - sized enterprises). Family farms growing cut flowers are rare in Africa. The major large-scale nurseries are owned by foreign investors, banks, wealthy individuals, cut-flower growers from Western Europe and local governments. At the major nurseries, the number of employees varies from a hundred to even thousands of people. The managers of these farms are often recruited from the United Kingdom, the Netherlands, Germany or Israel. On the other hand, local people have also set up small farms in recent years.

In Europe, flowers are sold mainly through the Dutch auctions or directly to wholesalers. Nowadays, the tendency is to bypass the Dutch auctions in favour of direct selling to supermarket chains and wholesale markets (such is the case with the UK market). For instance, between 1990 and 2000, sales of flowers from Kenya, Zimbabwe and Zambia directly to the British market increased tenfold. The main reason for this is that many companies (mainly Dutch and German companies) have established themselves in these countries, investing heavily to organize the horticultural sector. Moreover, local farmers have organized themselves into cooperatives to form holdings of 50 hectares and more, sometimes with the support of associations such as the Export Flower Growers Association of Zimbabwe and the Zambian Export Growers Association. In Zambia a central purchasing agency known as Agriflora buys directly from producers and bypasses the auction halls by selling direct to the supermarkets in Europe and North America.

Because of good coordination on the suppliers' side, Africa remains strong in products with high volume and low price. While growth is highly dependent on the availability of cheap airfreight facilities, further growth in production is possible, provided that capital is available.

High interest rates, together with stringent requirements, have systematically led small- to medium-size farmers to be excluded from accessing credit on reasonable terms and many operators to disappear. An example is the cut flowers industry in Uganda, which has faced serious problems in recent years. Cut flowers is a big industry in Uganda, representing 70 per cent of non-traditional exports and providing US$15 to 20 million a year. One reason for the crisis in the industry was the way in which the financing of the industry is structured. First, only short-term financing was available and that was not adequate for the young cut flowers industry. Moreover, loans were contracted in dollars and sales were effected mostly on the auction halls of the Netherlands in Dutch guilders (the euro has now replaced the guilder), a currency that at times depreciated in relation to the dollar. In consequence, the delays in reimbursement, combined with high interest rates, have made some firms in the industry insolvent and thus caused them to cease operations.

Access to offshore financing is also restricted, because of a perceived high performance and country risk as well as regulatory constraints on the part of international banks (if financing is for more than 360 days). In effect, what are required are appropriate financing structures that respond to the needs and requirements of the industry and will find ways of circumventing the obstacles while enabling relevant parties in this sector to perform their duties efficiently and access funds at fairer rates.

This chapter describes the main potential roles in finance of relevant parties involved in international horticulture trade. It also identifies the bottlenecks that need to be overcome along the financing continuum in order to enable various actors in each promising product chain to capture and sustain market opportunities. With the description of the activities of the parties, it becomes pertinent to look at ways of harmonizing the roles of each with a view to the achievement of better access to export funding on fairer terms.

A. The role of Governments

Governments play a crucial role in enhancing and promoting exports. Success may be achieved by introducing appropriate legal and regulatory reforms that are needed in order to improve the industry's access to finance; by enforcing proper rules and regulations (for instance, regulations related to phytosanitary issues); by assisting in the gathering of market information and in other marketing efforts; and by providing proper infrastructure. However, in many African countries, the Government has mostly failed to provide a supporting environment.

One of the problems that gives lenders concern about exposure to Africa is the risk of adverse government policies capable of affecting the performance of a facility. A situation where exporters are required to repatriate all export proceeds without regard to offshore financial obligations (or a situation where there is no possibility of a security mechanism for export proceeds repatriation) poses a grave risk to international lenders.

Furthermore, there are numerous infrastructural and other legal regulatory provisions such as aeroplanes' landing rights, or the very costly registration of charges over collateral, and many other rules which exporters consider inappropriate, too cumbersome and costly.

In addition, the provision of amenities such as irrigation projects and all-weather roads will go a long way to reducing the costs of doing business and therefore encourage exporters and develop efficient trade. African Governments should facilitate the development of such basic infrastructure, including also post-harvest handling facilities, decentralized cold storage (at airports for example), energy supply, transportation networks, telecommunication networks, and research-related work to develop better quality, new varieties and enhanced growing techniques.

Also one of the Government’s main roles in stimulating horticultural exports should be in the streamlining of the legal and regulatory framework to facilitate the smooth operation of loans and also to provide incentives, whether fiscal incentives (such as export tax exoneration or reduction of import taxes on certain main inputs), or financial incentives (such as partial financing or government guarantees on credits to small-scale enterprises), to enhance export finance and facilitate external trade. An example in box 3 describes the programme that Tunisia put in place in order to promote the development of the horticulture industry.

Box 3
Horticulture in Tunisia:
Exports incentives, financing instruments and marketing support structures*

Agriculture has always played a prominent role in Tunisia. Today, agriculture accounts for 15 per cent of GNP, 12 per cent of the total export of goods and 22 per cent of employment.

The main products exported (1999 figures) are olive oil (382.7 million Tunisian dinar = US$ 275.9)**, dates (53.5 MTD = US$ 38.57), market gardening (9.8 MTD = US$ 7.06), citrus fruit (8.5 MTD = US$ 6.12), flower growing (1 MTD = US$ 0.721) and wine.

Over the last decade several incentives have been provided to the agricultural sector to increase production and exports. These measures were made effective by the Agency for the Promotion of Agricultural Investments (APIA), which in 1993 promulgated the Code for Encouraging Investment in Agriculture and Fishing, and by a major programme for exports development through the facilitation of external trade. All these measures were taken to meet the concerns of the exporter, namely, the need to finance an activity at the lowest cost, to find the necessary credit to invest, produce, sell and insure exports' operations against the risks of non-payment, and to promote their export marketing and trade strategies.

(a) Code for Encouraging Investment in Agriculture and Fishing

The incentive code which also covers horticulture provides fiscal incentives (in the form of exemption and/or reduction of taxes for partially exporting resident enterprises and totally exporting enterprises) and financial incentives (partial financing of the investment cost through classified loan categories, study awards, investment awards, favourable interest rates for land loans, benefits granted to new promoters such as an investment award set at 6 per cent of the cost of the projects, or an undertaking by the State to pay the employers' contributions to the Social Security for salaries for Tunisian employees for the first five years of the business operating at full capacity), and a reimbursable grant not exceeding 70 per cent of the amount self-financed with a ceiling of DT 100,000 (US$ 72,100) - an interest rate of 3 per cent, and a length of reimbursement period of 12 years with a 5-year grace period.

(b) Financial instrument to enhance the support of production and export

In addition to investment credits to finance agricultural projects, farmers may receive short-term *operational credits* (seasonal crop credit, seasonal credit and advance credit on merchandise) and *export credit finance* from banks. However, given the reluctance of banks to grant advance export credit either because they do not know the exporting company sufficiently or because the company does not supply the customary guarantees, a fund to insure export financing before dispatch was set up in 1999. This fund guarantees reimbursement of the credit advanced by the bank.

- *National Guarantee Fund*

It is important to note that neither the operational credits nor the export credits benefit from any interest reduction. However, the operational credits are eligible for cover by the National Guarantee Fund (NGF), of which borrowers with insufficient guarantees have to be a member, in the opinion of their banks. The NGF was created by the Government in 1981 to support small and medium size agriculture enterprises and acts in the following three ways:

** Based on a paper entitled "Horticulture in Tunisia: exports incentives, financing instruments marketing and support structures", by Fethi Gritli, Director in charge of international relations, Tunisia Bank Company, UNCTAD May 2001.*
*** 1 Tunisian dinar = US$ 0.721.*

Box 3 (contd.)

1. Refinancing outstanding payments: Actions here relate to outstanding amounts on the principal. Conditions, particularly those relating to the amount, duration and interest rates, are set by decision of the Finance Ministry on the proposal of the Inter-departmental Committee. This concerns the taking on of the interest generated by the refinancing of the enterprise, which is no longer able to honour its commitments by reason of financial difficulties.
2. Taking on outstanding payments: Credit is considered to be irrecoverable when the bank has exhausted all legal means to recover the outstanding credit, thus establishing the complete insolvency of the beneficiary.
3. Taking on costs of pursuing and recovering of claims: The cost of subscription to the NGF is 1 per cent on the amount of the credit granted. This amount is paid by the beneficiary. The NGF will pay up to 90 per cent of the unpaid monies to the beneficiary: the outstanding 10 per cent is paid by the bank. Finally, the NGF intervenes when there is a drought officially confirmed by decree and it takes on all the interest relating to the rescheduling of repayments.

In 1999 a new - the Fund for Guaranteeing Financing for Exports - was created in order to facilitate exports for of small- and medium-sized enterprises by facilitating their access to pre-reshipment finance through a Pre-export Financing Guarantee certificate. This fund is being managed by COTUNACE (see below).

(c) Support structures for marketing and export promotion

Alongside APIA, the body responsible for the promotion of agricultural investment, there is COTUNACE (the Tunisian Company for Insuring External Trade) and CEPEX (the Centre for Promotion of Exports), which in their turn are responsible for facilitating marketing and promotion of exports in a general manner, including, of course, exports of agricultural goods.

- *COTUNACE*

Tunisia has set up a system for insuring exports which has been in operation for some 15 years and is adapted to the economic situation in the country. This system provides the exporter with protection against all external risks and covers losses which might have a negative effect. It allows the exporter to work on the global market both with both peace of mind and the necessary security. It also enables the exporter to obtain bank credit in the form of an advance on export operations to countries where the risk is not accepted by the bank. The three risks insured by COTUNACE are the following:
1. Commercial risk: This covers the risk relating to a private purchaser where the purchaser goes bankrupt, is in financial difficulty or simply refuses to pay.
2. Risk relating to a public buyer: This relates to the risk of a public buyer defaulting on payment.
3. Non-commercial risks: Risks here relate to war, troubles, riots and revolutions in the purchaser's country, non-transfer of currency and natural disasters.
Losses incurred from those risks are non-payment and contract interruption.

- *CEPEX*

It is not enough for the exporter to simply create a project and to benefit from the advantages and incentives for investment in the activity, nor is it sufficient to find solutions for financing the concern and insuring exports' operations against the risks of non-payment. It is also imperative that markets and purchasers be found to sell the goods. CEPEX (Centre for the Promotion of Exports) was therefore created in 1973 in order to support Tunisian exporters and foreign operators in their marketing efforts by providing them with a range of customized services.

CEPEX has two funds at its disposal to promote and improve strategies and the export environment:

- FOPRODEX: (Fund for Promoting Exports). FOPRODEX provides several subsidies for exporters in their activities to launch and promote their operations.
- FAMEX (Access Fund for Foreign Markets). This fund was created in 2000 to complement the facilities provided by FOPRODEX.

B. The role of producers, exporters and associations

Producers and exporters are the key players in the horticulture chain. The more organized producers and exporters are, the more bargaining power they have. Producers, exporters, organizations, if set up properly, can (a) enhance performance; (b) decrease dependence on middlemen; (c) increase the share of final export price which goes directly to the small-scale farmer by reducing the monopsony power of exporting firms and importing firms (whether the product is sold through the auction, agents or directly to the supermarket chains); (d) provide marketing strategies; and (e) enhance access to finance through group collaboration and by pooling resources to meet financiers’ requirements. For example, producers'/exporters' organizations may explore ways of building their financial sustainability by establishing bulk import of inputs at a locally competitive price. Moreover, as a way of boosting competition, exporters of horticultural products must deliver items of prime quality that meet international standards. This needs to be achieved through the use of adequate handling and storage facilities that enable the products to retain freshness up to delivery point. In view of the huge costs associated with the installation of these facilities, it may be beneficial for the exporters to group themselves together and pool resources and financing in order to acquire adequate machinery for servicing group members and others in the industry, who may so desire and who are willing to pay the required charges.[3]

There is also the issue of technical and managerial competence. Many financiers have expressed deep reservations about the technical and managerial competence of horticultural producers and exporters. This could be addressed by the organization through the provision of consultancy, technical information and back-up, as well through employment of agricultural specialists to provide assistance to growers on compulsory issues. The organization could also license exporters, and withdraw licences on repeated reports of quality problems – this would give banks more confidence in the skills of “licensed exporters”.

In view of the above, growers and exporters are also encouraged to form local handling agencies. A handling agent may be incorporated as a limited liability company with the growers and exporters as equity holders. The role of the agent can be multiple. For example, the agent could be the intermediary through whom a loan is accredited (an example of that is provided in box 4). With this, the agent can also provide all transportation and storage infrastructure necessary for effective handling of products. Such infrastructure will include refrigerated vehicles and storage cabins both on-site and at the airports of shipment. Additionally, the agent could coordinate activities with the offshore marketing agents to ensure that exporters get real value and timely settlement for their exports. The agent may be profit-driven and would charge the growers for services provided simply facilitating the activities of these operators for fee considerations. Exporters, however, will still be paid according to the ruling prices on the auction floors in Europe or to the prices agreed with their buyers, in the case of direct sales to supermarket chains, for example.

Furthermore, exporters and growers can explore the possibilities of marketing their products directly to supermarket chains. Where this is done, there is a need to appoint an agent (who can also be appointed by the buyers) to liaise with the buyers and coordinate with the carriers to ensure that deliveries are cleared promptly and supplied to the supermarkets in good time. Furthermore, the agent oversees the grading of the products to determine their real value. On completion of the deal, the agent also carries out other follow-up activities to ensure that payment is made.

[3] For example, flower production in Colombia only took off after the exporters had created an association with sufficient muscle to negotiate with airport authorities and airlines so that they invested in cold storage facilities at the airport, and with sufficient volume to charter aeroplanes to take their products to the United States.

Box 4
How can the agent obtain financing?

The agent can obtain financing for distribution to the exporters and/or growers. This option is feasible considering the fact that he will own pledgeable assets. The agent would have to work out arrangements with the exporters whereby he could pledge receivables of their contracts as security. This is feasible since the underlying purpose of the loans is in the interest of the growers and exporters. Moreover, as stakeholders in the equity of the agent company they are likely to wish to ensure its success.

A general structure of the proposed arrangement is provided below:

Lender:	International Bank
Borrower:	XYZ Company (“ the Agent”)
Amount:	US$ X
Purpose:	To enable the borrower to advance cash to exporters/or growers to meet their working capital needs.
Structure:	The structure of this facility is such that funds would be provided to the borrower in various tranches to be agreed for onward disbursement to the exporters and growers as the case may be. Prior to this, the borrower will open a collection account with the lender, into which proceeds of all assigned contracts would be paid.
Security:	(a) A charge over all fixed and floating assets of the Borrower. (b) Assignment of contract proceeds of the underlying borrowers valued, on the aggregate, at at least 125 per cent of the loan amount. Such assigned contracts to be acknowledged by the buyers directly to the lender. (c) All insurances taken by the Borrower and the participating exporters and growers, including political risk insurance, to be endorsed to the lender.
Repayment:	Repayment for the loans would come by way of the exports handled by the Agent and for which payments would be routed through the offshore marketing agent to the collection account established for this purpose.

A concrete example is discussed in chapter 4 (case study 4), where there is a description of how a producer with the assistance of his Agent can obtain pre-finance.

C. The role of local banks

There are a number of cooperative institutions providing both finance and financial services to growers, but none of them seem to have an answer for the exporting industries. They run at low capacities, largely because of lack of financial resources. The only sources of capital become the development banks and commercial banks. With few exceptions, African banks have been scalded by their previous experience in financing agricultural exports and have been moving away from agricultural finance to concentrate more on supposedly less risky (or good - risk) commodities such as oil or gold, and to finance exporters (rather than growers) of coffee, cocoa, tea and so forth. Now only large horticultural farms, which provide the requisite collateral, can expect to be financed by the commercial banks.

One reason why domestic banks have not been effective in developing financing mechanisms is that they have approached this market with the same financial products as are provided in OECD countries. However, developing country markets have different requirements with different and greater risks, which require structuring finance transactions that would leverage those risks and still enable good returns.

In the current situation, horticulture exporters in Africa usually wait for an average of between 30 and 120 days before they receive payment for their goods sold mainly to international buyers. During this waiting period, they have to borrow locally to pay their creditors as well as for working capital purposes so that they can remain in operation and produce for new export orders. In most cases, loans and overdraft facilities are used for such purposes. However, on most occasions, their financing needs are not fully met by these facilities, and not always on time. As such, this situation drastically affects their abilities to meet orders and manage costs effectively. Therefore, domestic banks may respond to the requirements of the market by playing a more significant role and by developing new innovative financial instruments from harvest up to the time of consumption of the goods. This would require banks to look for international lines of credit that are available through international financial institutions.[4] It would also necessitate a thorough analysis of the industry and proper due diligence in respect of the various flows of transactions in order to mitigate risks and ensure repayment.[5]

Similarly, local banks could serve as planks to leverage offshore financing for export activities in Africa. This can be done particularly through cooperation with their foreign parents, where appropriate, or their correspondent banks acting as financing intermediaries. Local banks may furnish international banks with needed credit information on exporters and monitor credit disbursement and repayment. A crucial factor in this arrangement, however, is the usual insistence by international banks that the local banks become the primary obligors, in which case they have primary responsibility for repayment of loans granted to exporters. This stance is most often resisted by the local banks, which prefer only to assume facility agent roles for commission considerations. On the other hand, this apathy towards assuming responsibility for such funds rather discourages international banks, which see no grounds to have confidence in local exporters when the local banks are reluctant to trust their performance and hence repayment capabilities. Local banks therefore need to evaluate their clients with a view to determining those with efficient performance record and therefore access financing for on-lending to them.

D. The role of international banks

From the international banks' point of view, horticulture is a difficult commodity to finance. In general, first, it is perishable; second, the value of the collateral may not always be determined beforehand; and third, the product may be handed over to consumers (and even consumed) before the final payments are made, while this horticulture produce is supposed to function as collateral for the loans to the exporter. Added to it the negative perception of international banks relative to African country risk, this leads to limited facilities from these banks to finance the sector.

There is, however, a need for international banks to participate in the finance and development of the horticultural sector in Africa and to appreciate the significance of the reforms being undertaken by many African countries, and on that basis to reappraise their perceptions of African risks. As a prelude, OECD Central Banks (and with them, the Basel Committee) may consider removing the blanket condition that all African exposure by their banks be regarded as doubtful debt and be fully provisioned as such in the balance sheet. When this is done, not only will financing flow to Africa increase but also funding costs will be reduced considerably.

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[4] In this respect, the role of multilateral financial institution in financing horticulture with special emphasis on facilities from and deals structured by Afreximbank are explained in ANNEX 2.

[5] The role of local banks in structured commodity finance has been extensively discussed by UNCTAD. One of the recent studies is "Potential applications of structured commodity financing techniques for banks in developing countries", UNCTAD/ITCD/COM/31. Other studies and papers related to commodity structured finance can be found on the on-line database of documents from the UNCTAD Commodities Branch, http://www.unctad.org/infocomm/comm_docs/themes.asp.

Furthermore, international banks, especially those with African subsidiaries, should work hand in hand with them and together identify producers and exporters with sufficient clout to warrant financing support. At the moment, medium to long-term funds are almost not available to the sector, and this seriously limits its capacity for growth.

Some horticultural exporters enjoy pre-financing at the discretion of the buyers, while others even obtained loans in advance from international banks before shipping their produce. However, the predominant mode of financing is post-shipment (mainly bill discounting using forfait or some other structures). This only refinances the growers for expenditure already incurred through borrowing from local banks at exorbitant rates. In view of the low profit margins, the growers may continue to move in circles with no potential for growth beyond present capacities. Currently, most exporters sell their products through offshore marketing agents representing their interests on the auction floors. In some cases, however, direct sales are also being made to the supermarket chains. Payments from the auctions/agents arrangement is not prompt, which can lead to the adoption of the forfaiting scheme, which pays the exporter a discounted value for his exports.

The role of international banks can be very valuable (particularly for exporters) in the horticultural sector as they have the capacity and experience to structure trade finance mechanisms that would bridge performance and country risks inherent in African deals, respond to the requirements of the market and offer good terms. Box 5 gives an example of how an international bank, with its knowledge of the market, and partnership with local banks assisted in the expansion of an exporting firm in the fruit market.

E. The role of offshore buyers/ supermarkets /auction floors

Horticultural products are very delicate and as such require a market that is willing, cooperative and ready. In this market, it is the buyer that calls the shots. Generally speaking, foreign buyers in the horticultural sector are not keen to open letters of credit to their sellers – in this case, African Exporters – but prefer to operate on open account, which is a simple method of paying cash on delivery of goods. This situation leaves horticultural exporters in Africa with no choice but to source for funds to generate exports and thereafter expect payments by the buyers. For these reasons, the relationship between exporters and buyers need to be very trustful, so as to avoid rejection of products for flimsy reasons or unfair pricing strategies that discourage investments for further production.

Furthermore, the role of buyers with the new financing mechanisms is very significant, as it becomes lenders' preferred risk hub. Since buyers are the source of payment in the trade transaction, their cooperation in a trade finance mechanism can add some measure of comfort to financiers. In a typical example, under the forfaiting financing structure (i.e. discount of export receivables), the lender only advances funds to an exporter on the strength of a promissory note issued by a buyer and avalized by his bank. In these circumstances, if a buyer is adamant about issuing his promissory notes at the contract stage, the exporter will not be able to obtain the necessary financing for generation of products for export. Overall, this stunts the growth of the sector. In the present situation, both supermarket chains and auction floors are less prepared, in comparison with traders and agents, to seek further guarantees or avals for their debt instruments to the exporters due to the fact that traders and agents have better contact with exporters. It is expected that as the new financing arrangement is deepened, auctions and supermarket chains will begin to appreciate the need for them to support the scheme.

Box 5
A tropical export finance facility of US$ 20 million

Arranger: MeesPierson Bank (now part of Fortis)
Borrower: One of the largest exporters of fruit from South Africa

The deal:
In 1999, MeesPierson saw a great deal of potential in the liberalizing South African fruit market. With the demise of the monopoly of Unifruco and Outspan on fruit export few years ago, many new parties have entered this market. Some of them successfully built a customer base all over the world. MeesPierson's client developed from a local distributor of fruit into a world player of substance within the space of two years. This change had implied an increase in credit requirements as well. MeesPierson, involved with the customer since the beginning of its export activities, assisted the company with structuring a new, enlarged facility of US$ 20 million.

The facility was available partly for advance payments to the farmers, and partly for goods during transport and for receivables finance in destination countries, mostly Europe. The facility was provided by MeesPierson, its joint venture partner FBC Fidelity Bank and Rand Merchant Bank.

The client was able to face stiff competition from the bigger world players in the fruit market by obtaining a finance structure that responded to his needs and market requirements.

Security:
The facility included a **collateral pool** where all the available collateral (stocks, receivables, shipping documents) were combined for the three banks. This pool was managed by MeesPierson.

The fruit trade has some specific characteristics that have to be taken into account. The farmers deliver their fruit to the exporter without knowing whether the end buyers will accept the fruit. Only upon arrival in the port of destination in Europe will the end buyers accept or reject the goods and will a final price be determined. If, during shipment, the demand for citrus collapses, the final price can be below expectancy. Therefore, the exporter arranges the logistics flow in an optimal way, so that the fruit arrives in a perfect condition. The exporter was also responsible for selecting the end buyers on performance.

Remarks:
One of the important elements in the accomplishment of the transaction is the experience, knowledge and contacts that MeesPierson had built up in the fruit market in Europe before offering its first export facility, in a collateral pool, to a South African client.

Moreover, having knowledge of the markets in the origin countries as well as in the destination countries enabled MeesPierson to satisfy the needs of its customers and to handle the risks involved in an optimal way.

Another important element is the local representation of MeesPierson in South Africa and its partnership with the local bank FBC Fidelity Bank. This enabled the financing transaction to be managed properly and smoothly while at the same time reducing performance and quality risk.

Source*: Trade and Forfaiting*, (1 April 1999, volume 2, issue 7).

In another scenario, where a good relationship exists between a grower/exporter and the buyer, the buyer can also enter into a contract with the exporter, enabling goods to be supplied to him in due course. Under this arrangement, the buyer can therefore advance funds to the exporter and such advances are deducted from the value of the products delivered, in due course. The advances need not necessarily be in cash but may also be in the form of inputs such as chemicals and pesticides valued at a price agreed with the grower/exporter. This is a form of buyer-credit which has immense potential for stimulating export growth in the horticultural sector. These loans depend largely on the relationship between the exporter and the buyer. Many buyers are still sceptical about advancing loans owing to lack of loyalty on the part of exporters, who could be shopping around for better prices in the market. In such circumstances, any advances provided to them may not be recovered. However, once due diligence is properly established, the strong fear on the part of buyers that exporters may side-market their produce to those offering higher prices would be mitigated and buyers would benefit from the advantages offered in these financing schemes.[6]

Box 6
The role of supermarkets in the integrated distribution of the horticulture sector

One key development over the past years is the rapid growth of supermarkets and their influence on horticulture trade. Supermarkets in developing countries have gained significance in supplying the food retail market.

The role of supermarkets has become very critical in terms of defining what is produced, how and by whom. Their size and market power means that the decisions they take to win customers and comply with food standards regulations define what the other actors in the chain have to do. The requirements they specify for cost, quality, delivery, product variety, innovation, food safety and quality systems help to determine what types of producers and processors are able to gain access to the fresh fruits and vegetables chain and the activities they must carry out. In the case of flowers, supermarkets were able to cut costs and thus were able to lower prices, and rapidly take market share.

Generally, supermarket chains do not own farms, processing facilities or import companies; they procure both globally and regionally and have stringent rules and conditions in order to maintain quality standards and meet their consumers' demand (many chains recruit or put their own staff in the production region to ensure product quality and availability). This trend had an impact on the entire sector: since large distribution chains have their own marketing policy, they are cost-attentive, and since they regularly buy large quantities of uniform, standardized and regularized quality product, they tend to exert considerable power to obtain a reduced price. Moreover, the retail/supermarket distribution channels usually bypass the wholesale market stage, thus avoiding intermediate handling and services costs. In addition, over the recent years, there has been a trend towards further consolidation among supermarket chains and growers/shippers in the fresh produce industry in order to better serve their large buyers. This has given them further incentive to meet their buyers' demands more efficiently, by providing a continuous and consistent supply of good-quality produce throughout the year (thus avoiding any break in the cold chain) at lower cost. As the result of large supermarket chains going global, demand has become more and concentrated, and competition has increased among traders and has adversely affected margins.

Source: Catherine Dolan, John Humphrey, and Carla Harris-Pascal, "Horticulture commodities chains: The impact on the UK market of the African fresh vegetable industry", IDS Working Paper 96, 1999.

As to auction floors, they also play a significant role in horticulture trading (mainly in the flower industry). Growers who ship their crops through the auction usually pay a sales commission (of 12 to 16 per cent), but they often have reduced marketing and promotional costs. A major benefit of selling through the auction is that growers are more or less sure that their produce will be sold (but without any guaranteed price), that the agent/cooperative will pay growers directly and that payments will go directly into growers' bank accounts. It eliminates having to give credit to customers for several

[6] This chapter and the following ones focus on export finance. They do not discuss the possibilities of structuring financing for horticultural producers around their contract sales to local supermarkets or local hotel chains. This is entirely possible and it is growing in importance as a possible source of financing for horticultural producers, in line with the rapid growth of supermarkets and international tourism in Africa. In general terms, it can be noted that such financings can be structured similarly to the export financings structured here – rather than relying on reimbursement from the producer, the financier relies on the supermarket or hotel chain, which will pay the financier as long as the producer has indeed performed. As the supermarkets or hotel chains have generally long-term competitive contracts with producers, the incentive for producers to default on contracts with these parties are not very strong, which can give considerable comfort to financiers.

weeks, and more importantly, it reduces the risk of bad debts.[7] Moreover, auction floors can further contribute to export expansion by providing an aval on their payments to enable growers to discount their receivables.

Another possibility would be for the growers to obtain offshore finance structured around their sales to the Dutch flower auctions (or even supermarket or international buyer). These auctions (buyers) accept assignments of payments – in other words, they agree to pay to a financier the money paid for exporters if this exporter has assigned these payments as reimbursement for a loan. Thus, using this financing mechanism, which has been used for some African exporters, would enable international financiers to eliminate the country risk and convert it into a performance risk. If this financing model is difficult to use, it probably indicates that African exporters do not have an acceptable track record.

F. The role of insurance

The role of insurance in strengthening credit and performance risk mitigating structures cannot be over-emphasized. Modern insurance covers have also become available to further reduce the risks in financing to Africa. Prominent among such insurance policies is political risk insurance. Traditional political risk covers include:

Pre-shipment contract frustration
(Covers the exporter's costs and expenses incurred in the manufacturing of goods, construction or loss of resale prior to amounts becoming due for payment.)

Post-shipment (or payment/credit risk)
(Provides cover for amounts due under a contract.)

Contract frustration (non-delivery)
(Covers the failure of a supplier to deliver goods which have been pre-financed or for which barter goods have been delivered in advance. The insurable loss is the value of such pre-finance or barter goods.)

Bond unfair calling
(Covers the unfair calling of on-demand stand-by letters of credit such as performance bonds. Calling such bonds following a political event such as trade embargo or license cancellation is also insurable.)

Confiscatory acts of government

(Covers the confiscatory acts of government for mobile assets such as consignment stock or fixed assets or investments in the foreign country. This includes government interference in project business such as cancellation of concessions.)

Political violence
(Covers the physical loss or damage to mobile or fixed assets due to such events as war, terrorism and civil commotion.)

As to performance risk in a pre-export horticulture finance transaction, there is also a grave risk of the exporter not being able to meet contract requirements due to unforeseen incidents. Inability to export could be caused by, for example, plant diseases and pests, adverse weather conditions and drought,

[7] Auction sales are done via two reverse style Dutch clocks. Prices start above the expected selling price and fall as the clock runs until the first buyer using an electronic key pad stops the clock. Unlike in the case of traditional auctions, it is the first buyer who gets the product. It is a fast, efficient selling method, with over 1,500 sales transactions per hour. Prices vary daily depending upon supply and demand. Selling product is a daily gamble since there are no guaranteed prices.

power cuts, strikes and workers' sabotage, poor service providers and sabotage. These can lead to a failure to meet exports schedules and hence loan repayment obligations.

Some insurance companies have introduced what is now known as “horticulturists’ policy” to insure against hazards affecting price and quality, such as deterioration of product in transit, machinery breakdown (cold room and pre-cooler machinery), fire and allied perils. Although these insurance products are making receivables-based financing easier, they do not cover market risk. Low prices in the market, caused by an oversupply situation or adverse international trends, are not insurable.

Moreover, some banks are working with insurance companies to enable growers to benefit from insurance policies that cover the risk of deterioration of product quality from farm to product in transit.

G. The role of rating agencies

A rating provides an indication as to the value and risk level inherent in an entity or asset. Where an asset is provided as collateral to secure a transaction, rating is aimed at evaluating the asset to determine whether it meets the agency’s standard for inclusion in the transaction. Assets are eligible collateral if they can be analysed as having either reliable stream of income or secondary market liquidation values. It is important to fully understand the potential credit risks inherent in the asset and how the asset can be used to ensure value to the financiers. Lenders rely to a large extent on the rating of companies or specific transactions (especially in the case of securitizations) to decide whether to join a financing syndicate.

There are two types of ratings: international and local ratings. The international rating of a company indicates the likelihood that it will reimburse a hard currency loan. In virtually all cases, this likelihood is deemed to be no better than the likelihood that the Government of the country in which the company is headquartered will reimburse its hard currency loans – in other words, the company’s rating will be constrained by the rating of its country. Only a handful of countries in Africa (e.g. Egypt, Mauritius, Morocco and South Africa) are rated, and the remainder are considered sub-investment grade. This ensures that all these countries will also receive a low rating, too low to receive international funds on the basis of rating alone.

The local rating expresses the risk that the company will be able to reimburse a local currency loan. This rating can be, say, AA (very good), even if the country’s rating is BB (sub-investment grade). Normally, local currency loans are expensive, but it is at times possible to structure loans in such a way that a “pass-through” to the international finance market is made, and the producer or exporter obtains a loan at international market conditions but reimbursable with local currency. If such a structure is feasible, it can give a company which has a local currency rating of, say, AA, credit at, say, A-terms. Unfortunately, local rating services are absent from virtually all African countries, and most companies, in particular in the horticultural sector, are thus simply unrated.

International rating agencies may consider expanding their services and rate more African entities, perhaps in cooperation with local banks and other interested parties. Given the peculiarities of most African economies, application of universal rating standards will obviously not give the African entities sufficient room to meet and hence they will continue to record low ratings. Therefore, other favourable environmental factors, such as economic and financial sector reforms, and cheaper operating costs, should be taken into consideration in the rating of African deals and entities. Certainly, the level of equity capital required to operate in Europe, for example, is not the same as in Africa, given the relatively low wage and other costs.

Chapter III

SUCCESSFUL EXPERIENCES

The aim of this chapter is to explore opportunities and ways to finance horticultural trade sector in the African region through learning from existing success structures and case studies. This section therefore analyses successful international structured trade finance transactions by evaluating their structure, risk mitigation and the essential elements that led to their successful applications.[8]

A. Case study I: Pre-shipment financing in Zimbabwe, 1997

This case study is of a pre-shipment finance for a transaction conducted in Zimbabwe through the British merchant bank Singer and Friedlander in 1997 (at a time when the international community still had confidence in Zimbabwe). It basically involved grouping of exporters through a marketing agent.

(a) Introduction

As a result of competition in the world market, Zimbabwean farmers, who have been involved in growing and exporting flowers since the early 1980s and had built for themselves a worldwide reputation for the production of high-quality flowers, had to update their production techniques in order to employ high-yield, low-cost production methods. However, the country's macroeconomic policies had not been particularly helpful in encouraging investment by farmers. High interest rates and inflation were impeding effective and significant growth of the floriculture industry. The liberalization of the economy, on the other hand, had resulted in various offshore lines being made available for reinvestment in Zimbabwe without the need for Reserve Bank approval.

A company called Hortifin (Pvt) Ltd. had identified investment potential in the floriculture industry in Zimbabwe and had set up a finance facility of US$ 60 million, through Singer and Friedlander, to be used to help flower growers to acquire modern facilities, in particular a new high-tech greenhouse concept that would lead to improved production yield per hectare per annum.

(b) Risk mitigation

To ensure that reputable growers were selected, Hortifin had identified Wingflora (Pvt) Ltd, an established flower marketing agency (and freight forwarding company), as the main vehicle for the deal. Wingflora, which had grown considerably in line with the growth of the floriculture industry in Zimbabwe, represented many reputable growers and therefore the activities of the growers could easily be monitored so that they were in line with the overall objectives. Another advantage was that Wingflora had concentrated its activities on high-quality/high-price flowers and had, as a result, realized selling prices above the average market price. Wingflora main roles were (a) to provide clients' track records; (b) to ensure that the products went to the international market; and (c) to ensure that all receivables (which were to be assigned) passed through it in order to repay the loan.

Hortifin became the agent of the growers eligible for financing. It was created for the sole purpose of monitoring the growers, and to make sure that the money was used for the production of high-quality flowers and that they were not marketing their flowers on the side. Thus the agent was present among farmers and had a direct link with Wingflora. Hortifin's main role was to process all applications for financing and to make sure the flowers arrived at the airport with Wingflora representatives. Hortifin was structured in such a way as to mitigate performance and delivery risks. Therefore, it also

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[8] The following three examples on Zimbabwe were presented by Edwin Maismba Moyo in his two papers "Horticulture trade finance: Zimbabwe examples" and "Horticultural trade finance: Tying Western counterparties into the deal" at the African Regional Workshop on Horticultural Sector Diversification, which was held by UNCTAD in May 2001 in Nairobi, Kenya.

requested the collateral of land and other assets from the growers as additional security on behalf of Wingflora.

In order to minimize the risk and to guarantee payment of the sums advanced through revenue earned on flowers exported, loan repayments were drawn directly from sales – that is, once the loan was approved, funds were to be disbursed to the farmer and repayments to be deducted from the selling point. An offshore special purpose account pledged to the lender (where all sales were assigned to) was set up for this purpose.

For insurance coverage, borrowers were required to carry insurance cover against "loss of profits" risk, and against any potential natural or inadvertent catastrophic damage to crops (such as weed killers).

(c) Main terms and conditions

Amount:	US$ 60 million.
Borrower:	A group of "selected" individual Zimbabwean flower growers.
Lender:	Singer & Friedlander Ltd.
Purpose:	Upgrading equipment used in the growing and dispatch of flowers.
Interest rate:	2.75 per cent p.a. over 6-month Libor fixed two business days prior to each interest period and payable 6 monthly in arrears. The interest rate to be calculated on an actual over 360-day year.
Management fee:	% flat calculated on the total amount and payable upon signature of the offer letter. The management fee to be non-refundable.
Commitment fee:	% p.a. calculated on the total amount of the loan and an actual over a 360-day year. The commitment fee to be payable 3 monthly in arrears. This is a fee paid per annum in order for the finance institution to commit the funds.
Tenor:	5 years from signature of the facility agreement.
Repayment:	10 equal semi-annual repayments commencing six months after the date of signature of the facility agreement.
Call option:	At the end of each 12-month period, if in the sole opinion of the lender there has been a change in the political or financial situation pertaining to the borrower likely to affect the security under the loan, the lender may call for immediate repayment.
Drawings:	Various drawings with 12 months covering purchases of equipment and working capital by the borrower in support of horticulture production.
Security:	Flower growers to commit all sales through Wingflora. Proceeds of all flower sales to be assigned to the lender and payable to an offshore special purpose account pledged to the lender. Percentage of monthly sale proceeds (at the lender's sole discretion) to be retained in offshore special purpose account to meet future payments of principal and interest.

Documentation: In form and substance satisfactory to all parties, including but not necessarily limited to:

Facility agreement containing clauses normal for this type of loan, including but not necessarily limited to, the following conditions:
a- Proper incorporation and constitution of the borrower;
b- Acceptability of growers to the lender;
c- Acceptability of buyers to the lender;
d- Acceptability of sales contracts of the lender;
e- Annual sales must at least equal outstanding loan amount;
f- Finalization of draw down schedule to the lender's satisfaction;
g- Perfection of all security items to the lender's satisfaction;
h- Completion and signature of all documentation.

Legal charge on the proceeds of the flower sales contracts satisfactory to the lender.

Legal charge on the offshore special purpose account satisfactory to the lender.

Insurance policies acceptable to the lender.

All necessary governmental and other approvals.

Zimbabwean and English legal opinions.

Assignment: At its sole discretion, the Lender may assign and or transfer, any of its rights or obligations under the Facility Agreement or any related agreement, without the Borrower's prior approval.

Governing law: English.

Taxation: All payments under the loan agreement are to be made free and clear of all present and future taxes, charges, deductions, liabilities and any other withholdings.

(d) Flow of the transaction

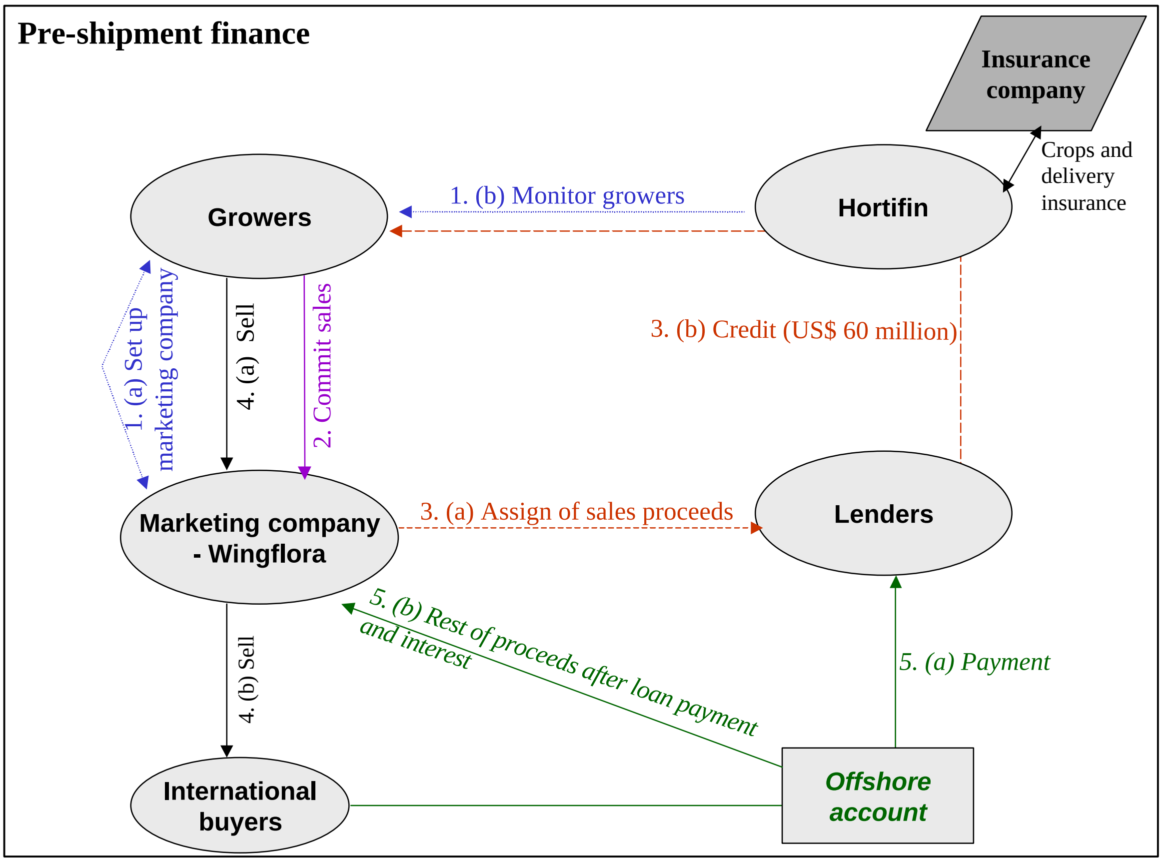
- A group of individual horticultural growers linked to one marketing company (Wingflora) were to form a special entity, Hortifin.

- The growers commit all sales through the marketing company.

- The proceeds of all sales are assigned to the lender and payable to an offshore special purpose account pledged to the lender. Thereafter the lender makes funds available.

- The growers export their products to Wingflora, which sells them on the international market.

- International buyers pay through the offshore account, charged to and controlled by the lender from which loan repayment and all associated charges and interest are made before the residual sum is remitted to Wingflora (which in turn distributes what is left to borrowers). A percentage of monthly sales proceeds, at the lender's request, is retained in an offshore account to meet future payments of principal and interest. As to prices, they were fixed according to the varieties being exported. They were based on average prices that those varieties had been fetching, both on the auction floor and on direct markets.



This method, however, depends on the confidence that international donors, who provide much of Zimbabwe's hard currency inflow, have in the country. Once donors lose confidence in a country, insurance companies such as ECGD, Hermes, NCM and COFACE, which normally cover country risks, will be very sceptical about providing such cover, as the risk of government intervention in the flow of hard currency earnings strongly increases. This makes pre-shipment financing difficult and expensive. Post-shipment finance can still be possible as country risks are moved offshore.

B. Case study II: Export receivables post-shipment financing in Zimbabwe, 1999

This example is designed to show the flexibility and efficiency of financing based on future sales flows in a situation of no confidence. It is a post-shipment finance example of a transaction for the horticultural industry carried out in Zimbabwe in 1999 at a time when the country's international confidence was at its lowest ebb.

(a) Introduction

At the beginning of 1999 Zimbabwe's image abroad took a tumble when the International Monetary Fund refused to release funding to support the balance of payments. As the year progressed a number of events ranging from land acquisition to pre-election violence undermined the country's confidence, and this caused the country's credit rating to go down dramatically. Banks overseas had become cautious about Zimbabwe's credit situation, mostly because of its economic mismanagement, which was causing payment problems (and a rapid fall of the local currency on the black market). Therefore, most foreign commercial banks had ceased granting or extending credit facilities to Zimbabwe. The limited credit coming into the country was short-term, expensive and/or heavily collateralized.

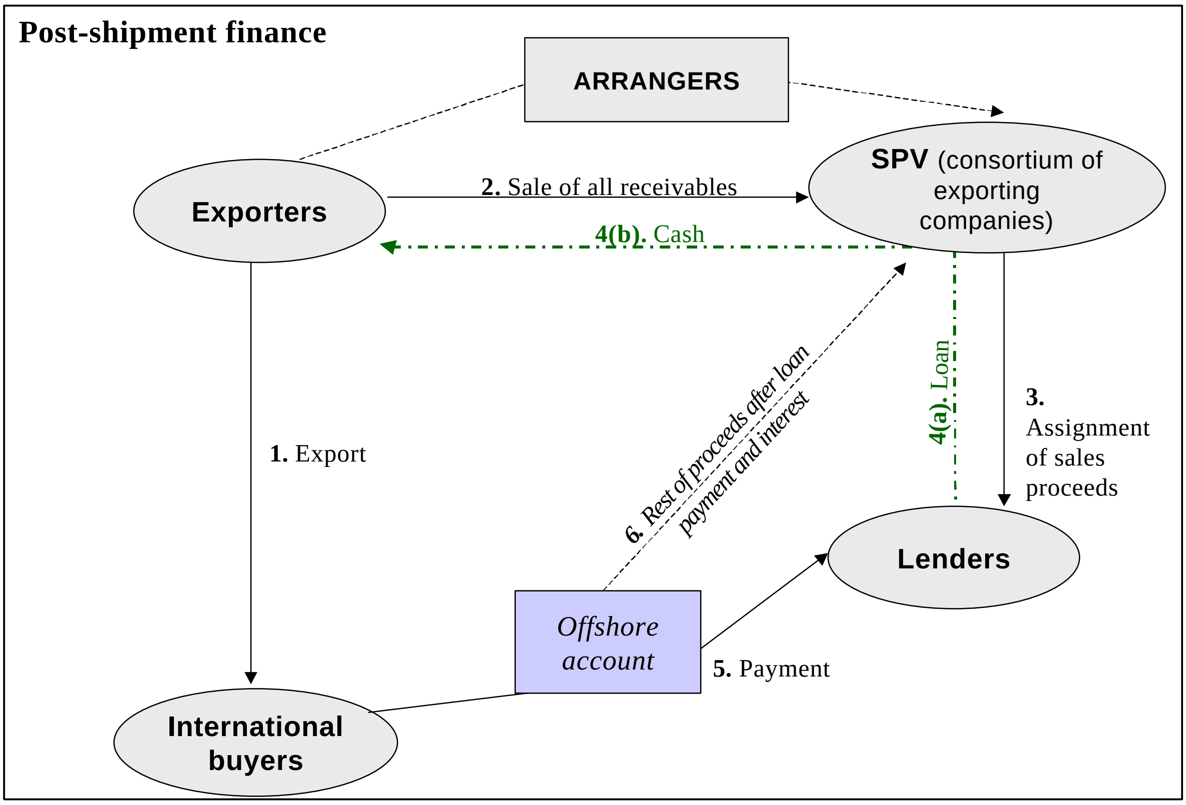
International donors were no longer willing to fund programmes in Zimbabwe. All this meant that financing based on future sales flows had to be structured differently, by moving payment risk out of Zimbabwe.

This situation, although particularly severe in Zimbabwe, can also be found in other sub-Saharan African countries. The result is high-risk premiums for borrowers, and a good reason to come up with structured export financing based on future sales flows.

(b) The structure

The structure envisaged pooling of horticultural exporters and raising funds in international markets through a single entity. The exporters were to create a Special Purpose Vehicle (SPV), domiciled offshore.[9]

This SPV was to raise a loan or bonds offshore that were collateralized by future export receipts arising from the exports of the exporters that created the SPV. The SPV was created to mitigate country risk, and in case of bankruptcy of the borrowers to protect the assets.



(c) Main terms and conditions

Total amount: US$ 50 – 100,000,000

[9] An SPV is a special entity to which the ownership of the commodities or other assets that are to serve as collateral are assigned. The SPV structure provides financiers with protection if the beneficiary of the finance (i.e. the producer) goes bankrupt, and makes it easier to classify the transfer of assets as a sale. The SPV is managed and controlled by a non-related bank which ensures that the financial flows resulting from the assets held as collateral are properly distributed.

Borrower:	Special Purpose Vehicle representing a consortium of exporting companies in Zimbabwe.
Arrangers:	Global Financial Services USA, Inc.; SARA Consulting Ltd, London.
Lenders:	A syndicate of international banks led by a prime international bank.
Purpose:	Finance of export receivables from importers acceptable to the lenders.
Tenor:	1 year but renewable annually at the option of the lenders.
Interest rate:	5 per cent p.a. over 6-month US$ Libor fixed two business days prior to each 6-month interest period and calculated on an actual over 360-day year. Interest to be payable at the end of each interest period.
Management fee:	% flat payable to the lenders on signing of the loan documentation. In the event of annual renewal of the financing, at each annual renewal date a further 1 per cent flat shall be payable to the lenders.
Arranger's fee:	% flat payable to the arrangers on signing of the loan documentation. In the event of annual renewal of the financing, at each annual renewal date a further 0.50 per cent flat shall be payable to the lenders.
Commitment Fee:	% p.a. calculated on the total undrawn amount of the financing at any one time and on an actual over 360-day year. Such commitment fee to be payable monthly in arrears.
Governing law:	English
Security:	Assignment of all export receivables by the consortium of Zimbabwean exporters. All drawings under the financing must be supported by irrevocable and unconditional export receivables totalling 125 per cent of each drawing, issued by importers acceptable to lenders (i.e. the Zimbabwean goods have been accepted by the importers and future payment of the receivables is unconditional). Special purpose offshore account in the name of the lenders through which all export receivables must flow.
Documentation:	In form and substance satisfactory to all parties but essentially: Loan agreement including clauses normal for this type of transaction. All necessary governmental and other approvals. Zimbabwean and English legal opinions.

C. Case study III: Forfaiting – Tesco/Fox Fresh Exports Zimbabwe

This example seeks to demonstrate how horticultural exporters in Africa can obtain cheaper sources of finance through forfaiting, thereby bringing buyers into the funding arrangement.

Under this forfaiting transaction, the local company (Fox Fresh Exports Zimbabwe) airfreights its flowers or fresh vegetables to a foreign buyer, in this case, Tesco Supermarkets in the United

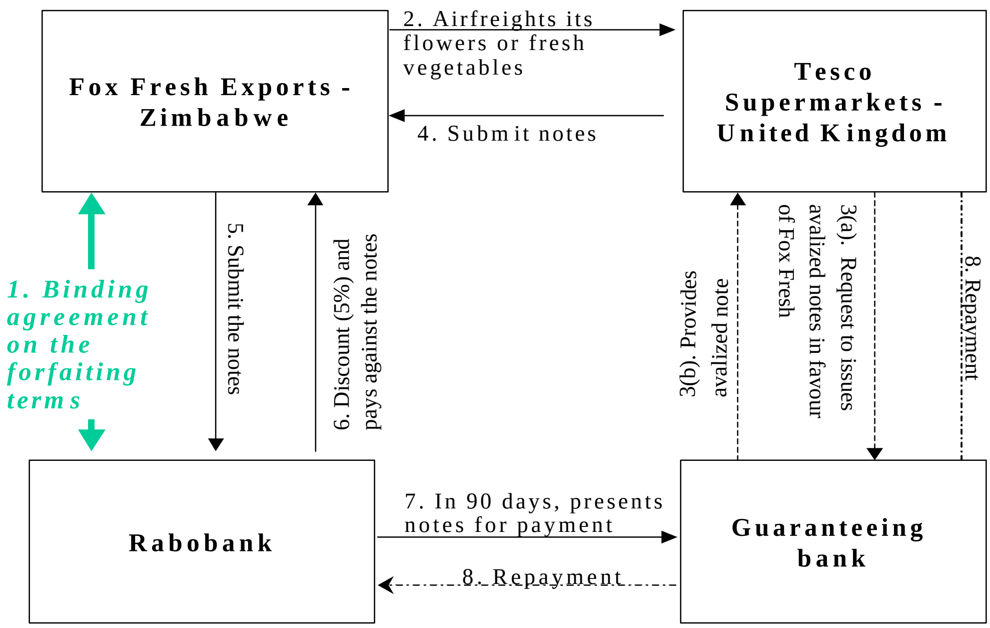
Kingdom. Tesco issues a tenored promissory note to the exporter. These notes are then avalized by Tesco's bank. Once the aval is added, the exporter, instead of waiting for 30 to 180 days for Tesco's payment and/or borrowing money on the local market to finance his working capital needs, can approach a bank for immediate payment in foreign currency less a discount rate. The exporter would then use the confirmed receivables backed by the aval of the bank as security and would thus receive payment two to four days after exporting. In this way, he is able to effectively borrow offshore without any exchange rate risks, and benefit also from all interest rates advantages.

Exporter:	Fox Fresh Exports Zimbabwe
Client:	Tesco Supermarket, UK
Export Value:	US$ 1,000,000
Discounting Bank:	Rabobank
Discount Rate:	5 per cent flat
Days to Payment (Maturity):	90 days
Value to Exporter:	US$ 950,000

(a) Procedures

(a) Fox Fresh Exports Zimbabwe receives confirmation of value of its exports and settlement dates from Tesco.
(b) Fox Fresh Exports Zimbabwe instructs Tesco to issue promissory notes to be paid through its bank to Rabobank.
(c) Tesco issues avalized promissory notes to the exporter (this is the traditional way; nowadays it is done more on a bank-to-bank basis whereby the buyer's bank issue notes to the exporter bank directly).
(d) Rabobank pays Fox Fresh Exports Zimbabwe less the discount (5per cent).
(e) In 90 days Tesco's bankers make final settlement to Rabobank.

(b) Advantages in the Tesco/Fox Fresh Exports Zimbabwe transaction



1. To the buyer (Tesco):
The buyer (Tesco) will enjoy better credit terms and as such will not be under too much pressure to pay immediately.

The buyer can now get the product, sell, receive money and invest it before final settlement in 90–180 days.

2. To the exporter (Fox Fresh Exports Zimbabwe):
Fox Fresh Exports Zimbabwe is paid within seven days of exporting.

As with most facilities currently on offer, this facility does not require any rigorous credit rating for Fox Fresh Exports Zimbabwe and all the inconveniencing procedures an exporter usually has to go through to obtain an offshore facility. In this case, all that is required is a promissory note or equivalent guarantee on the part of the foreign buyer, unequivocally indicating through his bank that he will pay within the agreed period.

Fox Fresh Exports Zimbabwe's competitiveness is enhanced as it can afford to give good credit terms to its foreign clients without worrying about cashflow.

Fox Fresh Exports Zimbabwe will not have to borrow locally or from offshore for working capital purposes because it will get payment for its exports almost on a cash basis (within seven days), hence borrowing costs are reduced dramatically.

Now that Fox Fresh Exports Zimbabwe will be getting its payment earlier than before, it can invest any idle portion of its foreign currency (after repatriating what is immediately needed for working capital) for a period of 60 days, in the case of Zimbabwe, before liquidation into Zimbabwe dollars as per the RBZ (Reserve Bank of Zimbabwe) requirements. This in effect means that Fox Fresh Exports Zimbabwe can recover some of the costs or charges made in the attempt to obtain prompt payment.

Fox Fresh Exports Zimbabwe can repay some of its loans (local loans), thus avoiding further crippling interest accruals, particularly if the loans are denominated in Zimbabwe dollar terms.

Fox Fresh Exports Zimbabwe can now increase its export turnover and plant efficiency because payment for sales is now on a cash basis.

3. To the bank (Rabobank):
Rabobank (the forfaitor) does not need to worry about country risk.

The facility is based on a transaction basis and the risk that Rabobank is taking is with the foreign buyer Tesco, and not with Fox Fresh Exports Zimbabwe.

4. To the country (Zimbabwe):
Zimbabwe is now collecting its foreign currency receipts faster than before, thereby improving on its balance of payments foreign currency reserves.

D. Case study IV: Pre-financing facility for exports of bananas from Côte d'Ivoire

The term sheet

The term sheet gives a bird's eye view of the main elements of a facility structure. It forms the basis for further negotiations between lender and borrower and is the platform on which future facility documentation is based.

1. The borrower: Company X. X is a major banana producer with a sales agreement through a prominent horticulture sales agent in Switzerland. Under the agreement with the agent, the borrower will covenant to ship a certain tonnage of bananas to the agent according to agreed schedules. The agent is also a shareholder in Company X.

2. The Lender: Bank A based in Europe.

3. The Agent: Company Z based in Switzerland. Company Z distributes to various retailers, food processors, supermarket chain retailers and wholesalers. The agent has supply agreements with a major food processor who will also be taking a substantial amount of bananas.

4. Amount: X million Swiss francs.

5. Type of facility: Revolving pre-export financing facility.

6. Purpose of facility: The facility is meant for the partial finance of banana export receivables due on export of products to be made by the borrower to the agent, who will be required to remit proceeds of payments directly to the lender.

7. Facility structure: The facility is structured in such a manner that upon generation of sufficient stock based on a sales agreement entered into with the agent under a rolling arrangement, the borrower draws down on the facility to an agreed amount. Such goods for export are evaluated by the lender on the basis of on price estimates established by the agent and make disbursements on that basis. The amount to be disbursed is captured in the disbursement modality in section 8. This procedure will be replicated in line with the revolving nature of the facility.

8. Disbursement

Mechanism: Each advance will be put at the disposition of the borrower in an account in a bank in Côte d'Ivoire. This will be triggered by the receipt by the lender of notes issued by the agent covering the value of the advance.

Initially at every request for an advance, the agent will establish an estimation of the selling price (in kilos). The amount of the advance will be calculated the basis of on an estimation, minus a fraction representing an estimation of overall handling costs (including shipping and transit fee as well as commission to the agent) minus another fraction as a security margin to take care of price shortfalls.

A hypothetical case is presented below:

Estimated selling price	==	SF --
Less shipping, commission etc.	==	SF --
Less security margin	==	SF --
Amount to finance	==	SF -- *multiplied* by the quantity shipped

9. Repayment

Arrangement: Repayment will come through assignment of notes issued by the agent to the lender covering the value of advances outstanding. Under normal circumstances the Agent would issue notes to the exporter, however in this case, notes are issued in favour of the lender (Bank A).

10. Security:
(a) For each advance a note is issued to the order of the lender by the agent.
(b) Assignment of all marine and other delivery insurance coverage.

11. Conditions precedent to draw down:
The facility will be available for draw down by the borrower on completion of the following:

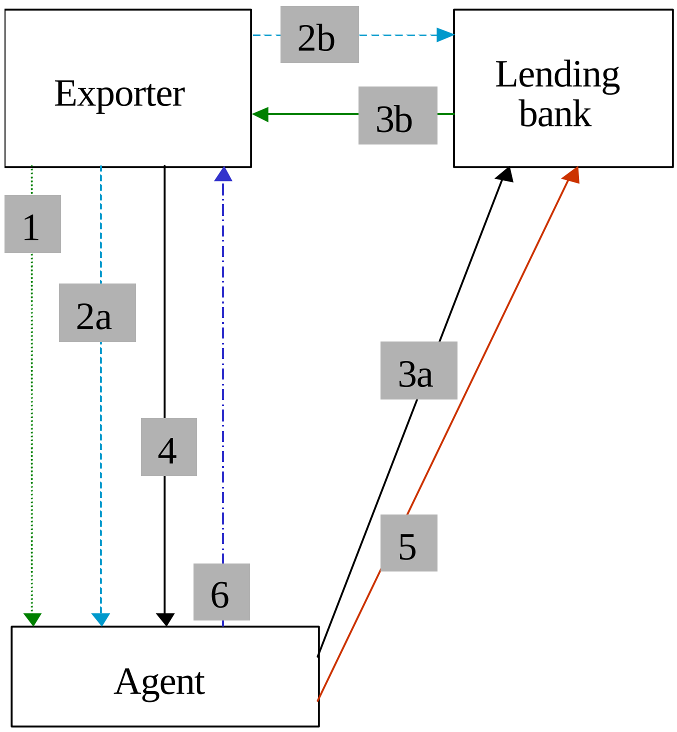
Before the first advance:

- Certified copy of certificate of incorporation and articles and memorandum of association of the borrower.
- Board resolution empowering management to take the facility.
- Copy of the sales agreement between the agent and the borrower.
- Copy of financial statements covering a period of three years.
- Confirmation of monthly average prices realized by the agent for the account of the borrower for the last 12 months.
- Written instruction by the borrower to the agent instructing the agent to notify the lender of the sales account at reasonable intervals.
- Written agreement between the borrower and the agent not to terminate or modify the sales agreement during the pendency of the facility.

After each advance:

- Copy of the shipping documents corresponding to the product being pre-financed by the advance.
- Copy of the estimation of sales price addressed by the agent to the borrower.
- Notification by the borrower of an intention to draw down made at least three days in advance indicating: (i) the name of the vessel; (ii) the departure date; (iii) the tonnage of the product covered by the advance; (iv) the price per kilo to serve as the basis for calculation of the advance; (v) the amount of the advance; and (vi) the date of the draw down.
- A note to the order of the bank, issued by the agent, representing the amount of the advance.
- Assignment of all insurances taken on the products in transit.
- Agreement by the agent to keep the lender informed about the condition of the banana market, including the average monthly sales prices. Information on buyers should also be provided.

Flow of the transaction



Once the exporter has enough quantity (of X tons) to export on the vessel, he informs the agent. On the basis of the current market price, the Agent determines a guide price to put on his invoice as well as a price of reference for the advance (details of calculation).
The exporter has the documents of loading and dispatches them to the agent, by informing him to have requested an advance (amount to be financed SF -- /kg). Simultaneously, the exporter transmits to the lender (Bank A) a request for an advance accompanied by copies of documents.
The lender grants the advance and officially notifies the agent (accusé de réception), showing receipt of it.
The agent takes delivery of the goods and issues his invoices (indicating the quantity, with terms of deliveries, names of the purchasers, terms of payment and expiry).
The agent makes payment of the gross value of the advance to the lender (Bank A).
The agent regularizes the account of the exporter and pays the residual of the sale.

Risks and mitigants

In order to make a transaction bankable one needs to identify all the risks involved in the underlying commercial transaction and try to mitigate them. The more risks are mitigated and the better the way in which those risks are mitigated, the better will be the terms on which the financing is available to the producer.

1. Performance risk of the borrower
This is the risk of the borrower not being able to generate sufficient bananas for export. After due thorough diligence study and technical analysis, this risk appears remote given the exporter's standing and production capabilities. The borrower is one of the major banana producers in his country. He is also engaged in the production of various other horticultural products such as pineapples. He produces up to 200,000 tonnes of bananas per annum. He has invested in new technologies to meet quality standards and to comply with ISO 14000.

Moreover, as he discounts the price estimates the lender finances only a portion of the overall cost of the products on board, thus bringing in a reasonable contribution from the borrower to the transaction. This is a key factor that will make the borrower have both financial and moral responsibility to work towards the success of the transaction

2. Risk of fund diversion
This is the risk of the borrower utilizing the advances for other activities than the export of bananas. There is a sales agreement between the borrower and the agent which gives the agent the sole right to market the products for the borrower in Europe. In line with this arrangement, there will be no disbursement of funds until products have been generated, thus eliminating the risk of fund diversion by the borrower.

3. Market risk
There is also a risk that the products may not be sold even when they arrive in Europe. This risk is, however, unlikely given the agent's sales network. His clients are wholesalers, chain distributors and processors. Eighty per cent of the banana imports are sold to one main processor giving comfort in that ripe bananas could be easily processed and avoid spoilage. Another advantage is that banana consumption is not affected by weather variations. Furthermore, the agent is highly reputable and the European market has a great demand for bananas, which is further strengthened by the fact that they are a tropical product that cannot grow in the region.

4. Payment risk
Prior to an advance being made, the agent would issue notes evidencing the debt obligation, further strengthening the repayment prospects and removing the payment risk from the borrower.

5. Price risk
There is a risk that prices could fall and in that case adversely affect the success of the transaction. This was taken care of by the financing of only a portion of the estimated price of the products in addition to a security margin; thus even in extreme price fluctuations, the lender would still recover the value of the facility.

6. Delivery risk
There is also a risk that products generated for export may not find loading space on outward bound vessels. This risk was mitigated by the financier, through the provision of advances only when goods are on board.

7. Quality risk
In the event of quality default arising from damage in transit, insurance claims will be payable to the lender. Where quality default arises from the borrower, there is no insurance coverage; if the goods

are rejected by the buyers the bank will not be able to recover its advance. One possibility would be for the bank to take the residual payments from previous exports repayment, or in the case of future exports, the bank would provide a reduced portion of the estimated selling price of the products (i.e. increasing the security margin) until it has recouped its advance on the rejected lot from the repayment received from end buyers.

8. Country risk
This does not arise since advances are made only when products are already loaded on the vessel, with payment coming from the agent domiciled offshore.

E. Case study V: Agriflora Zambia, post-shipment invoice financing[10]

This case study is of a simple post-shipment financing proposal for a horticultural company operating in Zambia, submitted by African Banking Corporation of Botswana Limited.

Agriflora Limited is a large Zambian-based horticultural company specializing in the production of vegetables and roses for sale mainly on the European markets. Whilst the final buyers of the produce are the large supermarkets and chain stores, the produce is sold to a number of agents who arrange for the distribution of the produce.

Sales are denominated in United States dollars, Sterling and Euros.

Typically, the buyers will expect anything from 30 to 120 days credit terms from Agriflora and some would stretch these terms for as long as possible. To improve the cash cycle of the company, African Banking Corporation was approached to enter into a "with recourse" invoice discounting arrangement with Agriflora.

The main terms and conditions of the structure were as follows:

Borrower: Agriflora Zambia Limited.

Arranger: African Banking Corporation of Botswana Limited.

Lenders: African Banking Corporation of Botswana Limited and/or a syndicate of banks.

Currency: United States dollars.

Facility amount: Up to US$ xxxxxxx.

Facility purpose: The proceeds of the facility are to be used by Agriflora Zambia to finance the production of various horticulture products for export to selected European buyers.

Modus operandi: The lenders will make available to the borrower a credit facility denominated in US dollars.

The interest rate applicable will be Libor-based, as described below.

Each draw down shall be treated as a separate transaction and shall be repaid within 120 days from date of draw down.

[10] This example was provided by Alistair Tite, Head, Structured Trade Finance, African Banking Corporation (International) Limited; e-mail: atite@africanbankingcorp.com.

Each draw down shall be debited to a US dollar denominated "Advance Account" to be opened in the books of the lender.

Accounts denominated in US dollars, sterling and euro will be opened at a bank acceptable to the lender – "the Collection Accounts".

The sales proceeds from the sales contracts shall be paid into such accounts.

The receipts to the Collection Accounts will be accumulated to meet the debt service obligations of the borrower.

On a predetermined date each month the credit balances held in the sterling and euro accounts will be converted into US dollars at the ruling spot rate of the day and credited to the US dollar account.

Any credit balance held in the Collection Account shall earn interest at the US dollar deposit rate of interest.

On a predetermined day of each month the credit balance held in the US dollar account shall be transferred to the advance receipt of the US dollar sales proceeds from the export contracts. They will be utilized to repay the loan account in the books of the Lenders.

Security: To include the following in favour of the lenders:

First priority assignment of all rights and claims of the borrower under and pursuant to the export contracts of the borrower and approved off-takers in form and substance acceptable to the lenders.

Acknowledged notices of assignment from each off-taker to pay all proceeds due under the sales contract directly into an account to be opened in the name of the borrower at an offshore bank acceptable to the lenders (the Collection Account).

A first charge over the Collection Account.

Undertaking from the borrower to:

- Fulfil its delivery obligations under each sales contract*;*
- Ensure repayment of the total outstanding under the facility, if necessary through assignment of additional sales contracts to the lenders.

Tenor: Each drawdown in terms of this facility is to be repaid within 120 days from date of drawdown.

Availability period: From the date on which all Conditions Precedent are met to XXXXXXXX.

Interest rate: 6 month Libor + xxx per cent.

Arranger's fee: xxx per cent flat on the facility amount.

Commitment fee: xx per cent per annum payable monthly in arrears on the undrawn, uncancelled amount of the facility during the availability period.

Costs and expenses: The borrower shall reimburse all reasonable and documented out-of-pocket expenses, including all legal, travel and accommodation costs incurred by the arranger in placing this facility.

Sales contracts: US dollar denominated, fix-priced export contracts satisfactory to the lenders, to be executed between the borrower and certain approved buyers (each an off-taker). The payment terms of each sales contract will incorporate an irrevocable undertaking the off-taker to remit payment into the Collection Account. The off-taker under each sales contract by will acknowledge such payment conditions.

Coverage ratio: The ratio of:

The amount receivable under the sales contracts in respect of exports to be made and due to be paid by the off-takers during the tenor of the facility

To

The principal amount of the facility:

Shall exceed 1.25:1 throughout the life of the Facility.

Undertakings: Undertakings required from the Borrower to include, *inter alia,* the following:

- That the coverage ratio will at all times exceed 1.25:1, or such other ratio as agreed between the parties.
- Not to amend, vary or waive any material term of the contracts without the prior written consent of the lender.
- Not to sell, transfer, assign or create any security interest on any of its rights to the foreign exchange resulting from the exports.

Taxes: All payments shall be made free and clear of any present or future taxes, withholdings or other deductions whatsoever.

Documentation: The facility is subject to the negotiation, execution and exchange of documentation satisfactory, in all respects, to the parties thereto, including a facility agreement, all documentation required to perfect the security and the sales contracts.

Conditions precedent: The conditions precedent will include the following:

Conclusion of documentation including the facility agreement, the security agreement and the sales contracts including irrevocable payment instructions and acknowledgements thereto.

Conclusion of a transport insurance policy with the lender nominated as loss payee.

Evidence that all necessary approvals from the Zambian authorities, including the approval, if necessary, of the Bank of Zambia are in place to permit the entry into force of this facility.

Legal opinion from a legal practitioner in Zambia as to the enforceability of the legal agreements and all related documentation entered into by the parties.

Governing laws: Laws of England or such jurisdiction to be agreed upon.

Jurisdiction: Courts of England or such courts as agreed upon.

CONCLUSION

The Horticulture sector offers Africa considerable potential for diversification, in terms of agricultural development and increased exports to regional and international markets. This is mainly due to the increase in global demand for good-quality products and the phasing out of agricultural subsidies in developed countries under WTO agreements, as well as the rationalization of tariffs and trade restrictions on food items. This should provide African countries with access to larger export markets and make them more price-competitive in international markets in both processed foods and fresh produce.

The Horticulture sector in both the processed and the fresh produce sector, if properly utilized, can provide African countries with real export market potential and can offer a significant economic opportunity in terms of foreign earnings and GDP. Since the US$ 7 billion international trade in fruits and vegetables is dominated by processed foods, it is here where the bigger opportunity lies. If current related problems such as infrastructure problems, and products' quality and packaging, are significantly minimized and improved, African countries will become a competitive exporter of horticultural products.

The introduction of new measures and related issues in the horticulture industry would require working capital, credit and investment support. However, there are many constraints that hamper access to credit at reasonable terms. This is mainly due to widespread mistrust, technical barriers and misunderstanding of the credit institutions, which consider horticulture to be a high-risk industry and therefore insist on substantial collateral, and stringent terms and repayment programmes for their loans. However, there are possibilities of arranging international structured finance transactions that would respond to the needs and requirements of the industry and increase the competitiveness of players in the industry by mitigating the risks and reducing the transaction costs, thus making exporters more competitive, stimulating diversification, and increasing the price that producers can expect to receive.

Financiers need to be aware of the industry's prospects since their role in the development of the sector in Africa is very important. They should play a facilitating role and bring their expertise where necessary. The potential offered by the use of structured finance mechanisms may be considered and adapted to the horticultural sector in Africa. This paper has reviewed the development and prospects of the world horticulture sector and its relevance to African export diversification and the role of the relevant parties in the drive to expand the production and export of African horticultural products. The risks that pose concerns to the financiers have also been examined, and some forms of mitigants and successful experiences have been evaluated as well. It is hoped that with determination and some confidence on the part of local banks and the international financing community, African exports of horticultural products will succeed in making substantial contributions to the continent’s overall trade portfolio.

ANNEX 1

HORTICULTURAL INDUSTRY TRENDS AND DEVELOPMENTS

The horticultural industry encompasses the intensive cultivation of many thousands of different types of fruits, vegetables, flowers and ornamental plants. Revenue returns can be as high as US$ 10,000 per ha, compared with the normal figure of around US$ 150–350 per ha which the extensive cultivation of crops such as grains or cotton generates. Even in developing countries, where the mix of technical support, management skills and production technology is often sub-optimal, the revenue from horticultural crops, if there is a ready market, largely surpasses that of traditional crops – for example, in much of Asia, returns per hectare for vegetables are twice those for intensive rice cultivation.

Developing countries account for 60–75 per cent of world horticultural production (Source: FAO). Both their domestic markets for horticultural markets and their horticultural exports have been expanding rapidly. Rapid urbanization and growing urban incomes have led to a steadily increasing urban demand for formerly "luxury" fruits and vegetables and even flowers, while reduced international transport costs and improved transport logistics (in the transport, packaging and storage of perishable goods) have opened up more international markets.

This section describes the situation of and developments regarding fruits and vegetables, and flowers. World production, consumption, trade patterns and marketing issues are discussed, with a focus on the salient features which will influence any financing scheme for these sectors

A. The fruits and vegetables sector [11]

The evolution of the fruits and vegetables sector is not homogeneous. A number of factors reflect the diversity: evolution of consumption, evolution of production techniques, socio-economic interests, general political situation, climate, production policies, international competition and international trade agreements.

The fruit and vegetable market is a buyer-driven market, where consumers are becoming increasingly demanding with respect to the quality of the products, the timeliness of their delivery, their origin, and the conditions under which they have been produced (with not only environmental but also social responsibility aspects playing an increasing role). Demand is increasingly varied, and customers want innovation in the line of products offered, but at competitive prices.

One key development over the past years is the rapid growth of supermarkets and their influence on horticulture trade. Supermarkets in developing countries have gained significance in supplying the food retail market.[12] The rise of supermarkets in Africa since the mid-1990s is transforming the food retail sector. Supermarkets have spread fast in Southern and Eastern Africa, already proliferating beyond middle-class big-city markets into smaller towns and poorer areas. Supplying supermarkets presents potentially large opportunities – and big challenges – for producers. Supermarkets'

[11] This section is inspired by two papers – "Worldwide impact of horticulture" by Urbain Avermaete and "Global horticulture impact: Fruits and vegetables in developing countries" by Andrea Segrè, presented at the *World Conference on Horticulture Research*, Rome, 17 – 20 June 1998.

[12] In Latin America, where the supermarkets' share in the food retail industry is estimated at present at 60 per cent (using data from 12 countries constituting 90 per cent of the economy of Latin America). Their share was about 15–20 per cent 10 years ago. The average share of the supermarkets in fruits and vegetables retail (consumption) is 25–30 per cent. That makes the supermarkets' market for fruits and vegetables in Latin America worth US$ 24 billion. In 2000, the total exports of all fruits and vegetables (raw and processed, and including bananas) from those countries was about US$ 10.5 billion. Excluding bananas, it was US$ 8.2 billion. (See "The rapid rise of supermarkets in Latin America: Challenges and opportunities for developments", in *Development Policy Review (4)*, September 2002. In the article, the authors, Dr. Thomas Reardon and Julio A. Berdegué, describe the rapid rise of supermarkets in Latin America.)

procurement systems involve purchase consolidation, a shift to specialized wholesalers, and tough private quality and safety standards. To meet these requirements, producers have to make investments and adopt new practices. That is hardest for small producers, who thus risk exclusion from dynamic urban markets increasingly dominated by supermarkets.[13]

Supermarkets in developed countries as well have captured a significant market share in supplying imported fruits and vegetables. As in developing countries, there has been a concentration of retailing in many markets. For example, in the United Kingdom the top four retailers (Tesco, Sainsbury's, Asda and Safeway) accounted in 1999 for about 75 per cent of all food sales, including sales of fruits and vegetables.[14]

(a) World production, consumption and trade practices [15]

Exports, which traditionally represented only a small share of the market for fruits and vegetables (though varying widely by commodity and country), have been increasing over the two past decades. This is mainly for two reasons: first, consumers are demanding wider varieties of exotic and foreign high-quality fresh fruits and vegetables; and second, they are demanding that fruits and vegetables be available all year round. This is well illustrated when looking at a typical general produce department of a supermarket in the United States, where the number of fresh produce units sold doubled in the course of one decade, from 173 in 1987 to 335 in 1997. At the same time, growth has been influenced essentially by economic development, which has led to an increase in per capita consumption of fruits and vegetables for medium-income countries in Asia, Latin America and Eastern Europe.

World production of vegetables has increased by over 55 per cent over the last 15 years. In 2002, world production was more than 500 million tons. The most important producing countries are Asia (with around 55–65 per cent of world production), the EU (11–15 per cent of world production) and United States. Over 100 types of vegetables are produced and consumed in the world and they are predominantly grown in consuming areas. Only the types having good taste and allowing for technical progress with respect to production, innovation and marketing are exported (this represents about 5–10 per cent of world production).

The development of world fruit production shows a similar trend, with substantial growth from just over 300 million tons in 1980 to 471 million tons in 2002, an increase of more than 50 per cent. Around 60 per cent of global production is consumed in the producing country itself. A further 30 per cent is used for processing (mostly into juice – which is traded predominantly in a pre-processed form as concentrate and wine). The remaining 9 per cent is exported as fresh produce.[16] However, there are great divergences between the export levels of different fruits, bananas being the most traded (with about 35 per cent of total exports in fruits), followed by citrus fruits with around 25 per cent and apples 19 per cent. In recent years, the export volumes of non-traditional fruits such as avocadoes, cranberries, dates, papayas and mangoes have experienced particularly rapid growth, of at least 50 per cent.

Production patterns of fruits and vegetables are different according to countries and types. Production in developed countries showed strong growth in the period 1950–1960, but it is now more or less stabilized. In developing countries, fruits and vegetables production has grown steadily since 1985, including in Africa. African countries have increased their overall share of world production, and fruits and vegetables now make up a large proportion of their exports. The trend towards higher production is not uniform in all the main producing countries, nor is it the same for all major products.

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[13] "The rise of supermarkets in Africa: Implications for agrifood systems and the rural poor", by Dave D. Weatherspoon and Thomas Reardon, Development Policy Review, 2003, May, 21 (3).
[14] "Horticulture commodity chains: The impact on the UK Market of the African fresh vegetable industry", by Catherine Dolan, John Humphrey and Carla Harris-Pascal, IDS Working Paper – 1996, 1999.
[15] The source for statistics is FAO.
[16] Source: Rabobank International, Industry Notes, http://www.rabobank.com/.

Overall the largest increase in production for both fruits and vegetables has been in Asia (particularly in Thailand and China) and in South America (Brazil and Chile). In Africa, the strongest growth has been in South Africa and Kenya.

Convenience of transportation plays a large role in the direction of export flows. For instance, countries of Latin America (Chile, Mexico, Ecuador and Costa Rica), export mainly to North America (United States and Canada). Asian countries (Thailand and China) mainly sell to Japan and the new emerging economies. Mediterranean countries (Turkey, Israel and Morocco) export to Europe. Sub-Saharan African countries sell principally to Europe, but the Middle East is also becoming a vital market. However, it is clear that improvements in techniques for transport, packaging and storage of perishable goods and the creation of large international commercial organizations have opened up wider opportunities for importing countries to diversify their sources of imports, leading to a global integration of trade in horticulture.

The EU imports about 40–45 per cent of the world trade in fruits and vegetables. It is also the largest world exporter of fruits and vegetables (with a share of 30–35 per cent). The United States ranks second as an importer of fruits and vegetables (19–24 per cent).

There are opportunities for developing countries to develop exports of "exotic" fresh fruits and vegetables. Some are already benefiting from this. In Kenya, for instance, fresh product lines are being developed specifically for the markets of the North, with products such as asparagus, courgettes and parsley. In addition, there is now a greater emphasis on diversified and healthy food, which has brought a niche export market for developing countries.

Developing countries can also obtain a larger share of the value-added. An increasing number of horticulture products are processed and exported using new techniques combined with new packaging materials and technologies. For example, vegetables which are packaged (e.g. for microwave use) and branded with a registered trademark are increasing rapidly in many developing countries. Vegetables are no longer just picked and shipped, but also chopped, washed, combined into multi-product packs, labelled and bar-coded. Supermarkets play an active role in transferring these tasks to developing countries. In South Africa and Kenya, this process is well underway and has paid marked dividends in the last recent years. The range of produce in this category includes canned green beans, peas, passion fruit concentrate, pineapple products, macadamia nuts, cashew nuts, dried mango and various prepared vegetables and salads.

(b) Quality issues

Quality is a highly important issue in horticultural trade. Consumers have become more conscious and concerned about this issue in recent years.

Producing horticultural crops for export is a much more difficult task than producing for local markets. Although developing countries are able to access international markets, they are always faced with the challenge of continuing to improve the quality of their products and meet industry standards. International trade of fruits and vegetables has become increasingly dominated by quality issues. Market players have been adapting logistics and services to meet consumer demands, and are actively promoting the image of quality. Minimum standards of quality, grading and labelling must be established and adhered to in order to satisfy the needs of the market and to be able to export, especially to developed countries.[17]

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[17] Quality elements which are important in export marketing include: grade of produce, defects, ingredients in processed products, mode of preparation of raw materials for processing, preparation and density of liquid medium, additives, drained weight, cleanliness, strength of container and packaging material.

Although organic products represent a relatively small portion of the world horticultural market, they are becoming increasingly popular and there is a growing demand for organically certified products in Western markets. The growth over the past two decades has been at rates of between 20 per cent and 25 per cent. The key to this growth is yet again the rising concerns of westerns consumers about quality issues in food products (i.e. the use of chemicals in food, pesticide residues and hormones). The clean green image of organic produce has provided some sense of security. The producers' shift to organics has been mainly driven by product differentiation, which offered them opportunities to access niche markets, and the price premium they would get on organic products. According to a Rabobank study,[18] price premiums for organics can be sold for up to 15 per cent more for widely distributed goods in conventional food stores. If the product is only available through specialty stores, premiums can reach 20–25 per cent, and in some countries and for some commodities even more. *Organic Monitor*[19] estimated that in 2002 the organic food market had a value of US$ 26 billion; and by 2008 the value is set to rise to US$ 80 billion, to reach US$ 102 billion in 2010. Supermarkets and other large-scale outlets are very much involved in this growth and are heavily investing in it.

Market	**Price premium over comparable non-organic food (per cent)**
Austria	*25–30*
Denmark	*20–30*
France	*25–30*
Italy	*35–100*
Germany	*20–50*
Netherlands	*15–20*
Sweden	*20–40*
Switzerland	*10–40*
United Kingdom	*30–50*
Japan	*10–20*
United States	*10–30*
Australia	*20–40*

***Source*: Rabobank International, various, 2002.

(c) The marketing and supply chain

Fruit and vegetable distribution is effected mainly through three different channels:

- A "short" channel of direct sales and local markets;
- "Traditional" distribution involving the physical presence of the products on a wholesale market (e.g. Rungis or Brussels);
- "Integrated" channels, which are becoming more and more important.

The overall chain of production and marketing in fruits and vegetables is long, and traders and central buying houses play a key role in it. The current fruit and vegetable trade industry is greatly fragmented, involving many small growers, enterprises and a great number of suppliers and traders. At the same time there are many retail outlets and formats, from large retail chains to small specialty shops and restaurants. The sector is very much buyer- and marketing-led, where traders mainly capture information and pass it back to growers via new orders to supply. Hence, it is common to see multinational corporations playing a role in coordinating production and marketing of commodities from certain countries, and governing the chain of activities that links widely dispersed producers to consumers in developed countries. An example of this is the role that the United States company Dole plays in the production and marketing of pineapples and other fruits from Asian countries such as the Philippines and Thailand. [20]

One of the main industry characteristics in recent years has been the growing role of supermarket chains in the integrated distribution of fruits and vegetables, whose shares in some countries exceed 50 per cent.

[18] "Organic food: An opportunity, at whose expense?" by Gillian Turco, Rabobank International, Industry Note, Food & Agribusiness Research, February 2002.
[19] *Organic Monitor* is an important provider of business intelligence on the international organic food industry; http://www.organicmonitor.com/.
[20] There are basically four top-listed world fruit traders (Dole, Fresh Del Monte, Chiquita and Fyffes), which capture more than 35 per cent of the world trade in fruits and vegetables.

B. Floriculture industry[21]

The floriculture industry comprises the cultivation of and trade in cut flowers, cut foliage, potted plants and bedding plants. Potted plants and cut flowers represent almost 80 per cent of the world trade in ornamental plant products. The floriculture industry is confronted with stringent legislation relating to produce quality. Adequate application of procedures and practices that enable effective quality assurance is essential for meeting demand and ensuring the maintenance and increase of market share in the future. Floriculture is a highly dynamic industry, and production is becoming technology– and capital–intensive. To compete successfully in the world market, it has become essential for floriculture growers to adopt new production technologies and to be innovative in terms of novelties and varieties.

(a) World production, consumption and trade practices

The world trade in floriculture products is estimated to be more than US$ 5 billion. According to the statistics available from the Flower Council of Holland, Switzerland, Norway, Germany, the Netherlands and Austria, in that order, are the countries with the highest per capita consumption of floriculture products (table 1). Growth in floriculture consumption and trade is greatly dependent on the economic development of the different parts of world and of course on the degree to which their cultures are flower-minded. Even within countries, purchasing patterns and habits differ by geographical region and income level. Among the new markets that have emerged in recent years are Eastern European countries, where economic growth has led to an increase in consumption and demand.

Table 1

Per capita consumption in euros (2000)

COUNTRY	Cut flowers	Plants
Belgium	40.8	15.9
China	0.6	-
Denmark	39.5	41.8
Germany	37.7	47.2
Finland	36.3	23.6
France	32.7	20.0
Greece	14.5	5.9
Hungary	10.0	5.0
Ireland	25.9	8.6
Italy	33.1	9.5
Japan	37.2	-
Croatia	5.9	5.5
Netherlands	51.3	27.2
Norway	56.7	53.6
Austria	43.6	30.0
Poland	7.7	2.3
Portugal	15.9	5.0
Russian Fed.	2.0	0.4
Slovenia	29.5	17.2
Slovakia	6.4	1.8
Spain	17.7	15.0
Czech Rep.	8.6	3.6
United Kingdom	35.9	10.9
United States	29.4	-
Sweden	36.8	41.3
Switzerland	87.1	38.6

Source: Bloemen Bureau Holland.

Besides the traditional centres of floriculture production (Netherlands, Italy, Belgium, Colombia and North America), new production centres in Latin America (Ecuador, Costa Rica, Guatemala and Mexico) and Africa (Kenya, Zimbabwe, South Africa, Zambia, Uganda and United Republic of Tanzania) have seen a very rapid increase in production and they are now important players at the international market. In 2001, Ecuador was the ninth world exporting country of floriculture products[22] (third in world export of fresh cut flowers, representing around 5.5 per cent of the world export share in floriculture). Kenya came tenth (fourth in world export of fresh cut flowers, representing around 4.5 per cent of the world export share in cut flowers). Furthermore, in Asia, countries such as Thailand, China, the Republic of Korea, India and Taiwan Province of China seem to have moved in the direction of more intensive horticulture, including in producing flowers.

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[21] Based on the study "Floriculture worldwide: Trade and consumption patterns" N.S.P. de Groot, Agricultural Economics Research Institute (LEI-DLO), P.O. Box 29703, NL-2502 LS, The Hague, Netherlands, e-mail: N.S.P.deGroot@lei.dlo.nl ; and the working paper "The world cut flower industry: Trends and prospects , "International Labour Organization, Sectoral Activities Programme, http://www.ilo.org/public/english/dialogue/sector/papers/ctflower/index.htm.

[22] This includes bulbs, plants, cut flowers and cut foliage. Source: Pathfind Publishing, http://www.pathfindpublishing.com/.

Europe is an import player in the floriculture market in terms of production, consumption and trade. The Netherlands covers around 50–60 per cent of the total trade of floricultural products (about US$ 3.7 billion worth of export of floricultural products for the year 2001 and more than US$ 500 million of imports). The products are mainly flowers (roses being the main traded product). Most floricultural products are sold through one of the eight auctions located throughout the country: cut flowers arriving by the planeload from around the world are sold by auctions or brokers, and then resold to other countries.

Most of the big auctions have representatives in the major supply countries throughout the world. They are looking for large, reliable year–round suppliers. Major merchandising companies are equally active finding or contract growing flowers for their bunching and distribution operations throughout the world. Besides imports from EU countries, which represent a large share of the total imports to the Netherlands, the share of developing countries is growing rapidly and the main non-EU suppliers are Kenya (Kenya sends over 60 per cent of its exports to the Dutch auctions), Zimbabwe (Zimbabwe 80 per cent of its exports is net to the Dutch auctions), Ecuador, Israel, Zambia over 90 per cent of its cut flowers is sent to Dutch auctions) and Colombia.

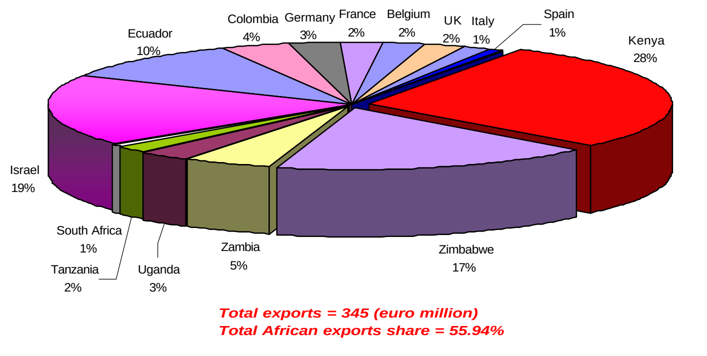
Africa has established very rapidly a satisfactory position on the export market mainly to Europe over the past decade. In a period of 10 years, Africa managed to increase its exports, especially to the Netherlands, the United Kingdom and France, by more than 300 per cent. Its total export of floriculture products was around US$ 355 million in 2001. Leading export countries are Kenya and Zimbabwe, which account for more than 70 per cent of exports, followed by South Africa, Zambia, Uganda, the United Republic of Tanzania, Morocco, Côte d'Ivoire and Mauritius. Kenya is now the world’s fourth largest producer of cut flowers after the Netherlands, Colombia and Israel. Exports from West Africa are very limited.

One of the main driving forces of the European flower market in recent years has again been the supermarkets and chain stores, which were not traditional flower-selling sites but have quickly established themselves as a major force in the market. In countries such as Switzerland and the United Kingdom supermarkets now account for 45 to 75 per cent of the flower market.

The supermarkets and chain stores have in effect built on their enormous customer base to develop a completely new and different market for flowers, which has led to an increase in volume competition, and lower-priced products and better quality.[23] At the same time, because of their highly developed transport system, supermarkets able to cut costs and thus lower prices, rapidly taking market share.

Rather than buying in an auction from unknown suppliers, supermarkets want to buy large quantities through long-term contracts, directly from known producers. Buying directly is the shortest route from grower to shop (which in a way ensures a certain quality) and is also important because supermarkets want to have certainty about the conditions under which the produce that they sell is being produced. It gives them more control over who their suppliers are, and more information on the conditions of work at these suppliers. It lowers costs and

Chart 1: Principal exporting countries of cut flowers to the Netherlands in 2000 (Euro million)



Source: Pathfast Publishing.

[23] In the United Kingdom where supermarkets have played an important role in developing the flower market and increasing the imports of flowers: imports to the United Kingdom accounted for about euro 578 million in 2000, compared with euro 494 million in 1999 and euro 474 million in 1998. Source: Pathfast Publishing.

reduces delay. In parallel to these changes, information technology and the Internet have also taken on an important role in the distribution channels of the floriculture industry.

African producers have been the main beneficiaries of the change in supply patterns. Supermarkets are interested in African flowers because they are inexpensive and because growers are willing to accept a set price. To the growers, the arrangement is attractive because supermarkets buy large quantities at pre-arranged prices. But in order to live up to their side of the bargain African growers must invest in optimal production methods. Often this includes investments in greenhouses, forced ventilation and heating, and in all cases greater attention to quality.

(b) Quality and price trends

Quality is a major issue in floriculture trade; mainly top-quality flowers are traded internationally. In the traditional markets in Europe, the United States and Japan, the consumer is becoming more sophisticated and critical regarding certain aspects of the product. The conditions under which flowers are being grown, their quality and environmentally sound production, wider varieties and novelties and service, in combination with the price, are the main weapons for market competition. For instance, the Dutch MPS and the German flower label (BGI) are important codes which were created in response to consumers' growing concerns about the way flowers and plants were being produced; and aimed at raising the awareness of participants and encouraging them to produce in a more environmentally friendly way; as well as improving the sector's generally poor image. Therefore, the trend nowadays is for growers and exporters to build up a good reputation and put greater emphasis on improving yields and quality, with more attention paid to direct marketing and attaining recognized eco-labels. However, all this demands considerable capital investment in pre- and post-harvest management – which includes grading, cold treatment and proper packaging and preservatives application.

Considerable *price differences exist with regard to quality*. Growers who have consistently delivered high-quality produce obtain higher prices than little known or irregular suppliers. Quality is to a large extent determined by vase life and by the moment the blossom opens up, something that is difficult to establish on visual inspection. Hence, the importance of reputation in determining prices. Moreover, new and "special" varieties of flowers can obtain better prices. On average, the higher the quality of the flowers, and the more specialized, the higher the price of the flower.

Prices of ornamental floricultural products also have other dimensions. World market prices of floriculture (flowers more precisely) are basically set at the Netherlands auctions because of their overwhelming market share. The intra-day price fluctuations can be quite significant. From day to day, climatic conditions can have a strong impact on short-term price levels. Moreover, there is a clear seasonal price pattern whereby prices (at the Netherlands auctions) reach their lowest level during the summer period when production in the "northern" countries reaches its peak and their highest level in November and December.

Horticulture exporters in developing countries, especially in Africa, usually wait for an average of between 45 and 60 days before they receive payment for their goods from their major buyers in OECD countries. During this waiting period, they have to borrow locally to pay their creditors as well as for working capital purposes so that they can remain in operation and produce for new export orders. In most cases, overdraft facilities are used for such purposes. However, most often, their financing needs are not fully met by these facilities, and not always on time. This makes it difficult for them to efficiently plan for orders and manage costs effectively. Thus, this situation drastically affects their abilities to meet orders and manage costs effectively. Moreover, in managing concentration risks, banks are sometimes not willing to support this sector notwithstanding the growth potentials.

On the other hand, buyers in OECD countries are generally mindful of their own cash flows, which could be affected by making upfront payments through letters of credit or pre payment, which are obligatory before goods are shipped. Usually, it takes between 30 and 90 days before they receive the imported goods. Some horticultural exporters in Zimbabwe used to enjoy pre-financing at the discretion of the buyers while others even obtained loans in advance from banks before shipping their produce. This system has since been discontinued because of Zimbabwe's low credit rating on the international market.

By paying upfront for goods (through cash collateralized Letters of credit), which are deliverable only after 30–90 days, the buyers are subjecting themselves to increased working capital costs through borrowing upfront to finance the importation. They will also be paying in advance for goods whose benefit will only be realized when the goods are sold.

It is for this reason that foreign buyers in the horticultural sector (supermarket chains, auction floors and traders) are not willing to open letters of credit to their sellers, in this case African exporters, but prefer to operate on open account, which is a simple method of paying cash on delivery of goods.

This situation has left horticultural exporters in Africa with no choice but to source for funds to generate exports and thereafter expect payments by the buyers. Unfortunately, in the horticulture market, the buyer calls the shots. In effect, the exporters seek funding at "all costs" to meet their export orders. This paper, therefore, has sought to demonstrate how horticultural exporters in developing countries, especially Africa, can obtain cheaper sources of finance through forfaiting, thereby bringing buyers into the funding arrangement.

Annex 2

THE ROLE OF MULTILATERAL FINANCIAL INSTITUTION IN FINANCING HORTICULTURES: FACILITIES FROM AND DEALS STRUCTURED BY AFREXIMBANK

by
Dr. B.O. Oramah and Mrs. C. Abou-Lehaf[24]

1. INTRODUCTION

The African Export-Import Bank, which has its headquarters in Cairo, Egypt, is an international EXIM Bank established in October 1993 based on the concept of global partnership. The Bank, which has a broad objective to promoting intra- and extra-Africa trade, owes its origin to the African Development Bank (ADB). At the 1987 Annual Meeting of the Board of Governors of the ADB, held in Cairo, Egypt, African Ministers of Finance adopted a Resolution requesting the ADB Management to conduct a study on the desirability of establishing a regional institution to provide trade finance facilities to promote trade, particularly intra-African trade. The greatest concern of the African Ministers was the very low level of intra-African trade (then at about 8% of total trade); the decline in financial flows to Africa; Africa's loss of global market share with African trade share of global trade standing at about 2.2%; the worsening external debt situation of many African countries; and the sharp reduction of lending to Africa by international commercial banks. They were convinced that a specialized continental financial institution was needed to spearhead the expansion of African trade.

The feasibility study, initiated in 1987, was completed in 1992 and formed the basis for the establishment of the Bank in October 1993. The Bank was established under the constitutive instruments of an Agreement, signed by member states, and which confers on the Bank the status of an international organization; and a Charter, signed by all Shareholders, which provides the general framework of the Bank's governance. The Bank's shareholders are categorized into three classes. The first category (Class "A") consists of African states, as well as African regional and sub-regional financial institutions. The second category (Class "B") consists of African national financial institutions and African private investors. The third category (Class "C") consists of international financial institutions and economic organizations and non-African private investors. The Bank's authorized share capital is US$ 750 million.

It is intended that when fully subscribed, the Bank's equity will be held 35%; 40% and 25% respectively by Classes "A", "B", and "C" shareholders. The shareholding structure is intended to ensure that the philosophy of partnership on which the Bank is built, is maintained.

This Annex is divided into five sections. This section provides a brief history of the Bank. Section 2 discusses the programmes and facilities the Bank has used to support horticulture exports while Section 3 discusses other programmes and facilities that can be useful in supporting the sector. Section 4 explains basic eligibility requirements for accessing the Bank's financial services. Section 5 concludes.

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2. PROGRAMMES AND FACILITIES USED BY THE BANK TO FINANCE HORTICULTURE EXPORTS

2.1 Key issues in financing horticulture

Horticultural products which include fruits, vegetables and cut flowers normally present some financing challenges, especially in a situation, as is usually the case in Africa, where the exporter presents a poor direct credit risk. In such instances, a prudent financier would prefer to design a structure that would transfer the payment risk away from the exporter to an acceptable buyer if the exporter's performance capability is considered acceptable.

In horticulture financing, however, this traditional structuring opportunity is constrained by the factors illustrated previously in this paper and which can be summarized as the following:

- The trade items are perishable and therefore have a short shelf-life with attendant risks as well as very high operating costs.
- In view of the peculiar nature of horticulture, it depends on very functional transportation infrastructure namely cold storage, good air-links, good port handling facilities, etc. These are, however, rare in Africa.
- Most growers and operators in the horticulture sector in Africa are small family enterprises. They make no attempts to inject equity funds into the business, waiting on the banks to provide even set up funds.
- Limited technical and managerial skills of African operators to acquire and apply appropriate and up-to-date production and post-harvest handling technology and to run a horticultural farm as a profitable business.
- Non-existent of local market for horticultural products in Africa poses danger to growers at a period of cancellation of orders by offshore buyers due to force majeure.
- Negative perception of international banks relative to African country risk.
- Due to its nature, horticulture trade is conducted on consignment basis thereby making it difficult to use receivables as a means of mitigating risk.
- The effects of the above is that it takes a lot of effort to structure such deals which in most cases are also of small sizes with little income earning potential.

Despite the above, Afreximbank has continued to support the sector using other means of risk mitigation. Two main products that have been used in supporting the sector are:

(1) Line of Credit
(2) Securitization of Credit-Linked Notes

We will now discuss in some detail how these programmes have been used to support horticulture exports.

2.1.1 Line of Credit

Purpose:
This programme was designed to enable the Bank assist small- and medium-sized exporters whose size and export volumes would not qualify them for the Bank's direct lending. Through this programme, the Bank provides funded and unfunded credit lines to credit-worthy banks designated as Trade Finance Intermediaries (TFIs) for on-lending to sub-borrowers. This programme accounted for the largest share of all approvals since the Bank's inception, reflecting the Bank's strategy of using banks as vehicles for risk mitigation and reaching medium-size exporters. Cumulative approvals under this programme amounted to US$823 million at the end of December 2002.

Beneficiaries:
- Central banks,
- Commercial banks,
- Finance companies,
- Export houses,
- Institutions active in trade finance in Africa,
- Similar institutions in non-participating states of the Bank (for financing of imports from participating states).

Available facilities under the Programme:
- Pre- and post- export financing
- Letter of Credit confirmation and refinancing
- Export credit guarantee facility
- Import Financing

Tenor:
360 days but extendable.

Pricing:
Linked to the Libor and related to country risk, transaction risk and market conditions

Documentation:
This may include a Facility Agreement, Sales Contract Assignment and Security Assignment Deeds.

How to Access the Programme
Prospective participating banks can access the programme by making a direct application to the President of the Afreximbank. The application must contain detailed information on the entity, ownership, history, organization, management 3-year financial statement as well as a detailed description of the envisaged transaction, and the country from where the entity operates. Sub-borrowers, African exporters and importers, as well as non-African importers of African goods, can access the programme by contacting a Participating bank in the country where it intends to do businesses (a list of participating banks is available on request).

Afreximbank Achievements

Through this programme, the Bank provided funded and unfunded credit lines to credit-worthy banks for on-lending to sub-borrowers engaged in horticulture exports.

A typical deal the Bank arranged in Zimbabwe involved financing exports of paprika and fruits to Europe through a local bank

The risks in the deal were identified as follows:

i) The performance risk of the exporter;
ii) product rejection risk;
iii) payment risk; and
iv) country risk.

In the deal, the Bank transferred the first three risks to the risk of the Zimbabwean local bank. To further support the credit of the local bank, the facility was secured by pledge of Zimbabwe government treasury bills effectively ensuring that there was an implicit government guarantee on the deal. The convertibility and transfer risks (country risk) arising therefrom were considered acceptable given that the Zimbabwean government was a signatory to the Bank Agreement and therefore was obligated to provide the Bank a preferred creditor status. The deal went well and there was indeed no need to cash the treasury bills.

The strength of the deal arose from the fact that the local bank knew the exporters and was on the ground to control and monitor their activities. Sales went largely to major names and supermarkets in Europe who met their obligations in order to keep the supply line open as Zimbabwe was a major supplier of some of the items.

2.1.2 Securitization

In another landmark deal that was structured on a multi-country basis, the Bank structured a securitization of Credit-linked Notes arising from horticulture exports from 4 African countries.

The salient terms of the deal were as follows:

Note Issuer: A Company created for the sole purpose of buying export receivables from African horticulture exporters.

Note Buyers: A group of international banks put together by the Arrangers.

Purpose: Proceeds of the facility were used by the Note Issuer in purchasing export receivables arising from exports already made by African exporters to acceptable buyers in OECD countries.

Structure: A bankruptcy-remote company (the “Company” or “Note Issuer”) was established whose sole purpose was to purchase debt instruments arising from exports made by African horticulture exporters to entities in OECD countries. Those debts were evidenced by Eligible Debt Instruments issued in international format by buyers of those exports. The Company issued Promissory Notes which

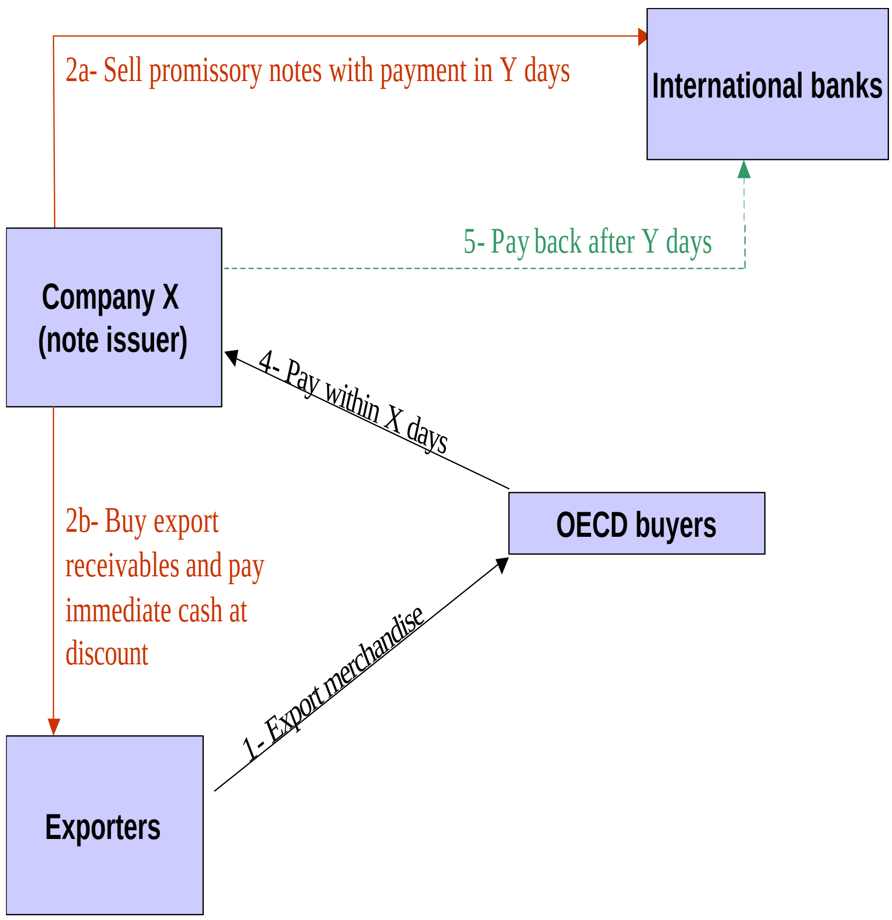
Note Buyers purchased, proceeds of which were used by the Company to purchase Eligible instruments. The Company, by way of security to the Note Buyers, endorsed the Eligible Instruments purchased from the proceeds of the Facility, to the Note Buyers. Those Instruments were held by the Agent who presented the debt instruments for redemption at maturity.

Eligible Instruments: The eligible instruments that the company could purchase with proceeds of the Facility were:
- Promissory Notes
- Bills of Exchange
- Drafts
- Letters of Credit

Eligible Importers: a) Prime corporates acceptable to the Arrangers
b) Other corporates; provided that the instruments issued were to have been avalized or guaranteed by a bank, corporate or sovereign acceptable to the Arrangers.

Security: a) Eligible instruments issued by Eligible Importers and endorsed to Note Buyers and held be the Agent.
b) Assignment to the Note Buyers of all assets owned or held as security by the Company.

This deal, with a ticket of USD50 million was considered a landmark and attracted a lot of interest in the market. It was designed to effectively transfer the risks of financing the horticulture to the credit risk of leading names and to enable the exporters to give credit terms to their buyers in a very competitive market.



3. OTHER PROGRAMMES AND FACILITIES

There are other programmes and facilities provided by the Bank that can be useful in promoting horticulture exports. We review some of these:

3.1 Country Risk Guarantee Facility[25]

This programme is aimed at making the sovereign risk of African countries more acceptable by transferring this risk to Afreximbank risk. Under this programme, Afreximbank guarantees international and African banks with credit exposures to Africa against certain country risk events. Guaranteed trade papers can be traded. The holder of the paper at maturity will be reimbursed in case certain country risk events occur.

Purpose:

- To enhance the financing of Africa's trade debts.
- To share risk with banks financing African trade, or credit insurance companies, providing cover against African trade risks.
- To cover financing banks where African country risk is found unacceptable.
- To reduce the stringent requirements for lending to Africa.
- To enhance the credit of African borrowers.

Beneficiaries:

- Banks and Export Finance Companies; and
- Insurance Institutions active in trade finance in Africa.

Tenor:
360 days but extendable.

Eligible Transactions:
Bank and Trade Credit including contingent obligations. Old (existing or previously contracted) debt and commercial credits would not qualify.

Eligible Items:
As in Section 2.2. above.

Eligible Countries:
Afreximbank Participating States.

Operational Modality:
Coverage is for up to 100% of lender's exposure with respect to specific country risk events, namely:

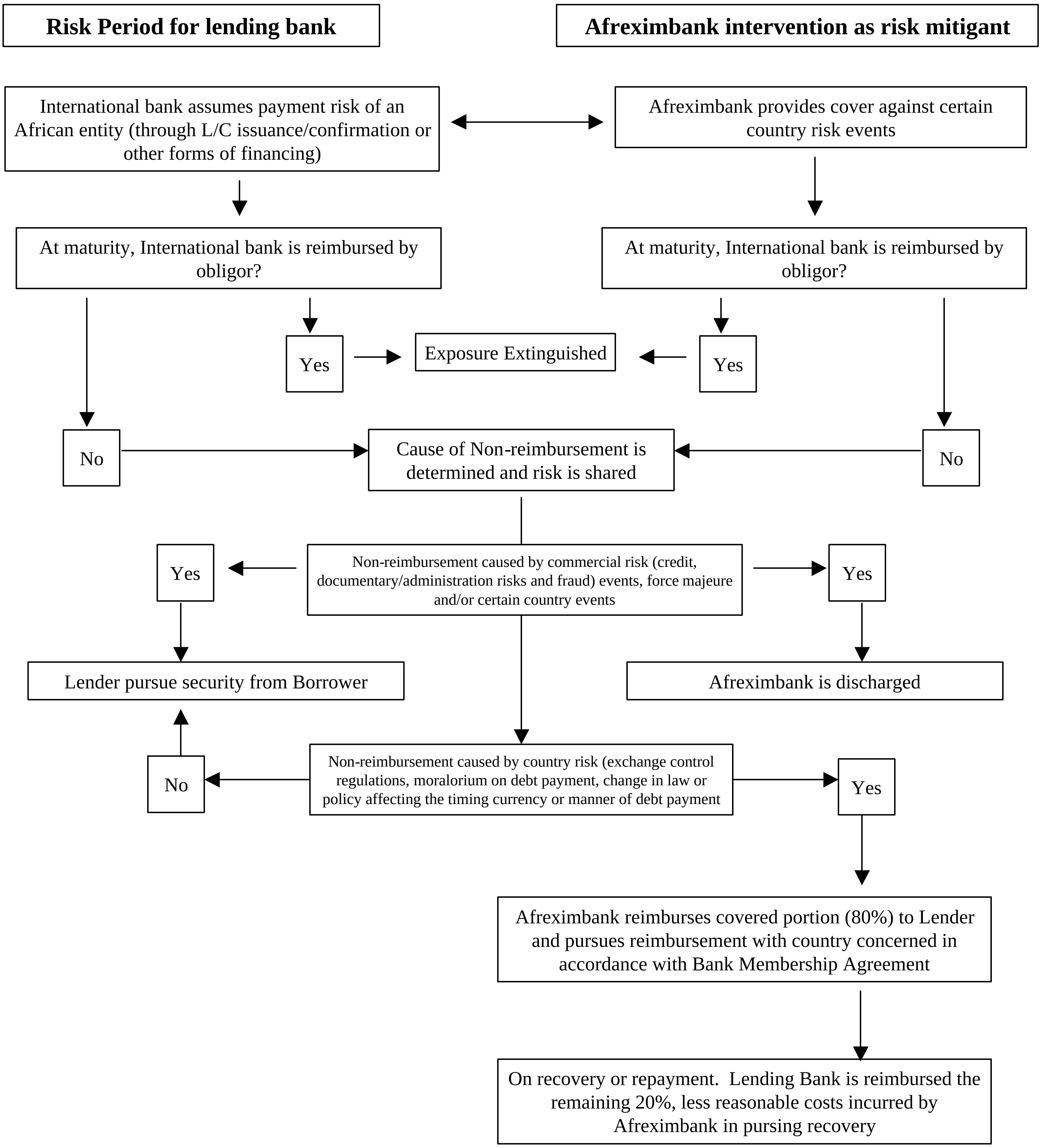
a. exchange control regulations;
b. moratorium on debt payment; and
c. change in law or policy affecting the timing, currency or manner of debt repayment.

Afreximbank's Comparative Advantage in providing the Guarantee:

- Afreximbank is an international financial institution and not subject to controls in any of its participating states. Thus, the credit risk of the Bank is the only consideration in determining any exposure to Afreximbank.

[25] See Figure 1

Figure 1
Afreximbank country risk guarantee
Facility flow of transactions



- The Bank is owned partly by African countries who are signatories to the Bank

Agreement. Under the Agreement, the Bank's property, assets and operations are in each participating state free from restrictions, regulations, supervisions, controls, moratoria, and other executive, administrative, fiscal and monetary restrictions of any nature (Article IX Afreximbank Agreement). Thus, Afreximbank enjoys preferred creditor status in member countries (similar to that enjoyed by the World Bank, African Development Bank, and some other multilateral organizations).

Benefits:
To African Traders:
Eases access to credit with better conditions

To Lending Banks:
Brings more comfort to grant more competitive terms, and to be more active in trade finance in Africa.

This facility can be made available to international banks interested in financing horticulture either directly or through local banks but are concerned about country risk of the home of record of the exporter. Such a risk may arise from introduction of policy requiring mandatory surrender of export revenues, retroactive imposition of export restrictions and similar policies. Should such deals fail because of any of those events, the Bank would pay the Lender and look up to the country for reimbursement in line with obligations such countries entered under the Bank Agreement. Direct Foreign Investors in the horticulture sector may also be covered under this guarantee.

3.2 Project Financing

Through this programme, the Bank could support the Continent's horticulture export product diversification effort by providing foreign currency financing to horticulture projects involving value-addition, e.g. canning, to enable them acquire equipment and raw materials for processing Africa's horticultural produce into semi-manufactured and manufactured products. Project financing may also be used in establishing horticulture export infrastructure, such as cold storage facilities.

Purpose:
Through this programme, the Bank provides foreign currency financing to private promoters of export projects to enable them acquire equipment and raw materials for processing Africa's raw commodities into semi-manufactured and manufactured products.

Beneficiaries:
- African corporates engaged in export manufacturing; and
- Entities seeking to expand export processing activities and who have existing export contracts.

Instruments for Programme Delivery:
The programme operates through:
- Line of Credit to Banks;
- Direct Financing;
- Syndication; and

- Risk Participation.

Tenor:
Maximum Tenor of advances under this facility is 7 years.

Pricing:
Linked to the Libor. Spread is determined by obligor, transaction and country risk a well as the tenor of the Loan.

Eligibility requirements:
The Bank also operates certain procurement rules, key aspects of which include:

- The procurement of second hand or used equipment is not encouraged.
- Procurement procedure must be conducted in a manner that involves competitive bids and multiple quotes.
- Cash disbursements are not made to parties other than suppliers.
- Additional funding requirements are to be warehoused with Afreximbank or participating banks. Alternatively, project promoters should show evidence that arrangements to meet additional funding requirements are in place.
- Down-payments must be supported with acceptable performance bonds from suppliers.
- Raw material and critical input plan must be provided.
- There is no provision for equipment leasing.
- Start-ups to show evidence of considerable previous experience in products to be produced.
- All corporate and Governmental approvals are to be in place.
- Environment and facility building to be fully provided for
- Suitable suppliers' warranty must protect Bank and promoter against deviations of equipment from order.

Documentation:
Appropriate Loan and Guarantee Agreements, Sale Contract, Assignment, Project (Technical) Documents, Support Documents, Security Documents Project, Export Opinions etc.

How to access the programme:
By application to the Bank providing all necessary information concerning the organization, including history, ownership, management, most recent audited financial information, recent export performance in that line of business, and technical details of the project, etc.

3.3 Export Venture Fund Scheme (in progress)

The Bank's Export Venture Fund Scheme which is expected to commence in the near-term can play a major role in supporting African emerging entrepreneurs dealing in the horticulture sector in order to boost the process of transforming Africa from a commodity exporter to an exporter of value-added products. When the Scheme becomes operational, it should be able to attract international venture capital, Foreign Direct Investment, and assist in attracting foreign partners who would provide technical and managerial skills as well as outlets, and provide other convergence services necessary for supporting venture export projects in the horticulture sector.

3.4 Afreximbank Trade Information Programme

The Bank provides African banks, exporters and foreign investors with interest in African trade, with relevant information on African economies, commodities and markets. It also publishes a biannual trade journal through which it disseminates African trade information. Arrangements are in progress to introduce an on-line African trade database which can be subscribed to by entities interested in African trade. The available trade information in the Bank can be accessed by contacting the Bank's Planning and Development Department.

4. BASIC ELIGIBILITY REQUIREMENTS FOR ACCESSING THE BANK'S FINANCIAL SERVICES:

4.1 Eligible Entities and Countries

The Bank credit facilities are available only to:

a. Shareholders and/or non-Shareholders in "Participating States", namely those states whose Ministries of Finance or Central Banks have subscribed to the Bank's share capital and/or whose Governments have signed and ratified or acceded to the Bank Agreement.
b. Shareholders in non-Participating States; and
c. Non-Shareholders in non-Participating States but only to the extent that such financing will be used to pay for imports from a Participating State.

4.2 Eligible Transactions

The following transactions are eligible for financing by the Bank:

a. All eligible exports for participating states;
b. All eligible imports of participating states; that is, export-generating African imports including raw materials, equipment, space parts and other essential items;
c. Intra-African trade in eligible items;
d. South-south trade in eligible items; and
e. All eligible imports of non-participating state from participating states.

5. CONCLUSION

This annex gave a brief history about the Bank and presented the programmes and facilities the Bank has introduced to enable it meet the challenge of enlarging Africa's access to external financing and in promoting African trade. It also presented the Bank's programmes and facilities which have been put into use to serve horticulture exports.

As can seen along this annex, Afreximbank is valuable in enhancing the development of the horticultural sector as it has the capacity and experience to structure trade finance mechanism in horticulture sector. This would bridge performance and country risks inherent in African deals and respond to the requirements of the African market.